

COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY

11th & L BUILDING, SUITE 550, (916) 445-2125  
SACRAMENTO 95814



H O R S E R A C I N G I N C A L I F O R N I A :  
R E V E N U E A N D R E G U L A T I O N

A STUDY  
BY THE  
COMMISSION ON CALIFORNIA STATE GOVERNMENT  
ORGANIZATION AND ECONOMY

JULY 1982

Chairman — Nathan Shapell • Vice-Chairman — Senator Milton Marks  
Senator Alfred E. Alquist • James M. Bouskos • Mary Anne Chalker • Benjamin Felton • Albert Gersten, Jr. • Brooke Knapp  
Manning J. Post • Richard S. Trugman • Assemblyman Frank Vicencia • Jean Kindy Walker • Assemblyman Phillip D. Wyman  
Executive Director — L. H. Halcomb

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SACRAMENTO 95814



July 20, 1982

Honorable Edmund G. Brown Jr.  
Governor of California

Honorable David A. Roberti  
President pro Tempore of the Senate  
and to Members of the Senate

Honorable Willie L. Brown, Jr.  
Speaker of the Assembly  
and to Members of the Assembly

Dear Governor and Members of the Legislature:

In 1980, AB 3383 significantly amended state horse racing laws. In particular the measure reduced 1981 state horse racing revenues by \$14.3 million from 1980 and increased annual racing associations' and horsemen's revenues for the same year by \$59 million. This dramatic shifting of racing revenues was based on a 1979 study, funded by the racing associations, that claimed racing associations and horsemen could not continue their involvement in horse racing without substantial financial relief.

Based on an analysis of the financial statements of the major racing associations, prepared at our request by the State Controller's Office, we found the associations to be very profitable investments. It appears, therefore, that this redistribution of racing revenue unjustifiably increased revenues to racing associations and unnecessarily reduced state racing revenues. (The effects of this measure are discussed in detail in Chapter III of this report.)

The California horse racing industry is one of the largest and most profitable in the United States. In 1981, this multi-million dollar industry generated over \$2 billion in California's total pari-mutuel wagering, and about \$119 million in state racing revenues.

The California Horse Racing Board has statutory responsibility for regulating the industry, including collection of state revenue and the protection of the public. Our review of the board's operation indicates severe deficiencies in, 1) the board's adherence to state budgeting procedures, 2) use of board staff, 3) monitoring of racing participants, and 4) collection and deposit of state

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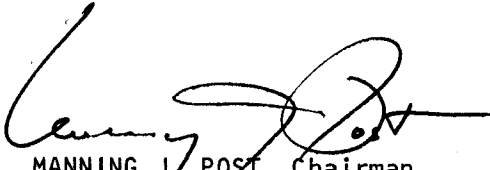
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July 20, 1982

racine revenues. The State Department of Finance has instituted a number of severe budgetary controls that will prevent the future recurrence of many of these managerial improprieties.

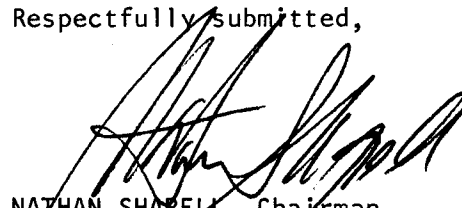
The members of the Horse Racing Board should be chagrined by the very need for such drastic steps. Although the Commission emphatically supports the actions of the Department of Finance, our analysis indicates that this alone will not ensure proper regulation of the racing industry. We therefore urge the Legislature and admonish the Horse Racing Board to take such steps as necessary to implement the recommendations contained in this report.

In a related review, we analyzed the California Exposition and State Fair's contracts with Lloyd Arnold Food Service and Golden Bear Raceway. We determined that the contracts inequitably favor the lessee at the state's expense. The Commission recommends that both the Food Service and the Golden Bear Raceway contracts be substantially renegotiated to assert the state's interest.



MANNING J. POST, Chairman  
California Horse Racing  
Board Study Subcommittee  
Jean Kindy Walker

Respectfully submitted,



NATHAN SHAPELL, Chairman  
Senator Milton Marks, Vice Chairman  
Senator Alfred E. Alquist  
James M. Bouskos  
Mary Anne Chalker  
Benjamin Felton\*  
Albert Gersten, Jr.  
Brooke Knapp  
Richard S. Trugman  
Assemblyman Frank Vicencia\*\*  
Assemblyman Phillip D. Wyman

\* Dissent

\*\* Assemblyman Vicencia's comments regarding  
this report are contained in Appendix F.

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## I. INTRODUCTION

The California Horse Racing Board (CHRB) under current law is delegated the responsibility of regulating horse racing in California. The board is expressly directed to assure the protection of the public, the maximization of state revenues, the continued growth of horse breeding within the state, and the uniformity of regulations governing each type of horse racing. The State Horse Racing Law grants the board broad regulatory authority including licensing racing participants; adopting necessary rules and regulations; administering and enforcing the rules, regulations, and state racing law; adjudicating any controversies arising from its enforcement activities; and allocating racing dates.

The CHRB was organized in 1933 following the passage of a constitutional amendment. The board is comprised of seven public members (appointed by the Governor) with a support staff in 1981-82 of 49.4 authorized positions. Total expenditures for the 1981-82 fiscal year are estimated to be about \$2,338,000. (This consists of a total appropriation of \$1,338,000 and \$1,000,000 in reimbursements for the stewards' program.)

During the 1981-82 fiscal year, the board collected an estimated \$120 million in state racing revenues. Of that total approximately \$103 million was deposited in the General Fund, and about \$17 million was deposited in the Fair and Exposition (F&E) and the Wildlife Restoration Funds (\$750,000 is statutorily appropriated to the Wildlife Restoration Fund, the remaining \$16 million was deposited in the F&E Fund).





## II. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Based upon our review of the California horse racing industry, we find that:

1. State horse racing revenues in calendar year 1981 were \$14.3 million less than in 1980 while revenues to associations and horsemen increased by \$59.2 million.
2. Virtually all the increase in wagering activity from 1980 to 1981 is accounted for as a continuation of historic growth in wagering and the innovation of Pick-Six wagering. Although AB 3383 (Chapter 1075, Statutes of 1980) did not significantly increase total wagering, it had the net effect of redistributing take out monies so that the state's share fell from \$.69 to \$.47 for every dollar paid to associations and horsemen--a relative loss of 32 percent. The overall fiscal impact, discussed more fully in Chapter III and Appendix A of this report, was a giveaway of between \$25 million and \$31 million in potential 1981 state racing revenues.
3. AB 3383 changes to state law were based upon a 1979 report made by Temple, Barker and Sloan, a consulting firm retained by the racing associations. The report, entitled "An Analysis of the California Horse Racing Industry," claimed that without substantial financial relief, horsemen and racing associations could not continue their involvement in horse racing. We were unable to ascertain the financial condition of horsemen. However, through financial ratio analysis, we determined that most racing associations have consistently outperformed other comparable private businesses. Based upon this analysis, the racing associations, prior to enactment of AB 3383 were very lucrative investments. In view of these findings, the Commission recommends that the Legislature reconsider their action on AB 3383.
4. The CHRB overspent its 1980-81 budget appropriation, ignored an executive order, and violated the State Government Code. In addition, the board:
  - Violated numerous provisions of the State Administrative Manual;
  - Failed during the preparation of its 1982-83 budget to follow the directions of the Department of Finance, resulting in a loss of \$30,000 in salaries, wages, and benefits;
  - Misspent stewards' funds;
  - Used surplus personnel services account funds to cover over-expenditures in its Operating Expenses and Equipment Account;
  - Failed to maintain adequate control and restraint over its budget thus resulting in unnecessary costs and inefficient use of the board's resources and state funds.

Accordingly, we support the action taken by the Department of Finance. (In response to an audit performed by its staff, Finance is, in essence, setting itself up as a conservator over the board's budget.) The Department's action will prevent a future recurrence of the violations. The very need of such drastic steps, however, should be a source of embarrassment to members of the Horse Racing Board. Board members should hold their staff accountable and ensure that all recommendations of the DOF are speedily enacted.

5. Stewards' rulings vary depending on the type of racing and the track. The rulings, in many cases, are not sufficiently severe to constitute a deterrent. Therefore, we recommend that the CHRB establish mandatory uniform punitive guidelines for the stewards. Such guidelines should ensure uniformity between the various types of racing and that the various penalties are severe enough to be a deterrent.
6. The current occupational license fees, on an annual basis, are less than the fees charged in 1975. The board is proposing an increase, but the new fee structures, on an annual basis, will only be at or slightly above the 1978 levels.
7. The Department of Finance indicates that it would support any request for additional staff that is accompanied with an off-setting increase in funding. The CHRB claims it is understaffed and has been unable to acquire Finance support. Accordingly, we recommend that the CHRB offset any proposed increase in licensing and/or field staff with an increase in occupational license fees.
8. The organization and format of the various financial audits the board requires racing participants to file is not consistent, making any financial comparison difficult and in some cases impossible. We therefore recommend that the board adopt guidelines outlining an acceptable format, and require that all audits be filed in conformance with those guidelines.
9. State Racing Law requires Racing Associations to disperse charity racing revenues "as soon as practicable" after their collection. One Southern California Thoroughbred Racing Association held its 1980 charity revenues (\$678,000) for over 9 months before dispersal was made. Interest earnings to the association on these monies could easily have exceeded \$50,000 over the 9-month period. As of May 1982, this same association had not dispersed charity monies collected from its November 1981 meet. This activity is entirely inappropriate, and constitutes a violation of the State Racing Law. Therefore, we recommend that the Legislature clarify existing law and require racing associations to make timely payments of charity monies to charity foundations. Until such time as the law is clarified, we recommend that the California Horse Racing Board sufficiently monitor the associations so as to ensure the prompt and timely payment of charity monies to charity foundations.
10. State license fees are not being collected and/or deposited in a timely fashion. This cost the state between \$50,000 and \$100,000 in

annual General Fund interest earnings. We recommend that as long as racing associations are permitted to pay on a weekly basis, the California Horse Racing Board require those payments to be made on Mondays. We also admonish the board, whenever possible, to deposit these monies on the day of receipt.

11. Each racing association conducting a racing meet is required, under current law, to deposit \$10,000 with the State Treasurer as security against payment of its state racing fees. In 1981, the total handle exceeded \$2 billion with some racing associations experiencing daily handles in excess of \$4 million. The \$10,000 security deposit is no longer sufficient to protect state interests. Accordingly, we recommend that the Legislature require racing associations to post performance bonds equal to at least 15 days worth of State License Fees.
12. The Auditor General, at our request, conducted a performance audit of the CHRB's activities. On completion of this study in March of 1982, the Auditor General issued a report making several recommendations to the board. It is of interest to note that two of the recommendations were nearly identical to those made by the Auditor General in a 1976 review of the Horse Racing Board. We feel the Auditor General's recommendations are of value and if implemented could greatly improve the board's ability to properly manage the \$2 billion horse racing industry. Accordingly, we recommend that the Auditor General closely monitor the progress of the California Horse Racing Board to ensure compliance with the Auditor General's recommendations.
13. In response to our request, the Controller's Office, Division of Audits, audited the California Exposition and State Fair's contract with Lloyd Arnold Food Service and Golden Bear Raceway. The review determined that: (1) Cal Expo's contracting procedures are in violation of the State Administrative Manual; (2) The contract with Lloyd Arnold Food Service grants the concessionaire exclusive year-round use of the facilities but only requires rent to be paid during the 14-day State Fair racing meet; (3) Lloyd Arnold Food Service (LAFS) paid Golden Bear Raceway (GBR) \$176,748 in 1980 and \$139,630 in 1981 for the privilege of operating the concessions during GBR's 1980 and 1981 Cal Expo harness meet. These payments are peculiar since the state contract exclusively authorizes LAFS to operate the concession during this meet; (4) GBR's contract with Cal Expo gratuitously subsidizes the rental of office space and allows inordinately low rents for use of Cal Expo.

We conclude that the provisions of these contracts are heavily weighted in favor of the lessee. Accordingly, we recommend that Cal Expo conform its contracting procedure to the provisions of the State Administrative Manual. To protect the state's proprietary interests, we further recommend that any future deliberations of these contracts be attended by an independent representative.



### III. AB 3383 (CHAPTER 1075, STATUTES OF 1980)

AB 3383 made a number of significant changes to the State Horse Racing Law. The gamut of changes included:

- an increase in the number of racing weeks allowed to an association per year,
- an increase in racing associations' commissions and horsemen's purses,
- an increase in the awards for breeders, owners, and stallions associated with California-bred thoroughbreds,
- redistribution of the unclaimed pari-mutuel winnings,
- a decrease in the state's share of the breakage (odd cents on winnings), and
- a decrease in state license fees.

The enrolled bill report prepared by the Department of Finance estimated the act would reduce annual state racing revenues by \$18 million. The report recommended that the measure be vetoed. Commenting on Finance's estimated revenue loss, the legislative analyst said, "We believe these to be conservative projections of the bill's impact on state revenues."<sup>1/</sup> The Governor signed the bill and it became law on January 1, 1981.

#### Revenue Impact

Because its effective date was midway in the 1980-81 fiscal year, the most effective means of illustrating the impact of Chapter 1075 on horse racing is to compare the activity in the 1980 and the 1981 calendar years.<sup>2/</sup>

A direct comparison of the activity in these two years (See Table 1 below) shows the following:

- an increase of \$44.9 million or 13.6 percent in the take out,
- an increase in commissions paid to associations of \$27.4 million or 26.2 percent,
- an increase in horsemen's purses of \$31.8 million or 35.1 percent, and
- a decrease of \$14.3 million or 10.7 percent in state license fee revenues.

This direct comparison, however, understates the actual impact of the measure on potential state racing revenues in 1981 and succeeding years.

<sup>1/</sup> Analysis of AB 3383 (Vicencia) as amended in Senate June 17, 1980, published June 23, 1980.

<sup>2/</sup> See Tables A to F, Appendix A, for additional data.

TABLE 1  
COMPARISON OF 1980 AND 1981 PARI-MUTUEL TAKE OUT (INCLUDING BREAKAGE)

<u>Recipient</u>	<u>1980</u>		<u>1981</u>		<u>Change 1980 to 1981</u>	
	<u>Amount In Millions</u>	<u>Percentage of Take Out</u>	<u>Amount In Millions</u>	<u>Percentage of Take Out</u>	<u>Dollars</u>	<u>Percent</u>
State <sup>1/</sup>	\$133.9	40.71%	\$119.6	32.00%	-\$14.3	-10.68%
Associations	\$104.4	31.74%	\$131.8	35.25%	+\$27.4	+26.25%
Owners & Breeders	\$ 90.6	27.55%	\$122.4	32.75%	+\$31.8	+35.10%
Sub-Total Revenue to Assoc. & Horsemen	\$195.0	59.29%	\$254.2	68.00%	+\$59.2	+30.36%
TOTAL TAKE OUT	\$328.9	100.0%	\$373.8	100.0%	+\$44.9	+13.65%

<sup>1/</sup> The State's share of the Take Out does not include unclaimed winning tickets.  
See footnote to Figure 1, page 9, for this detail.

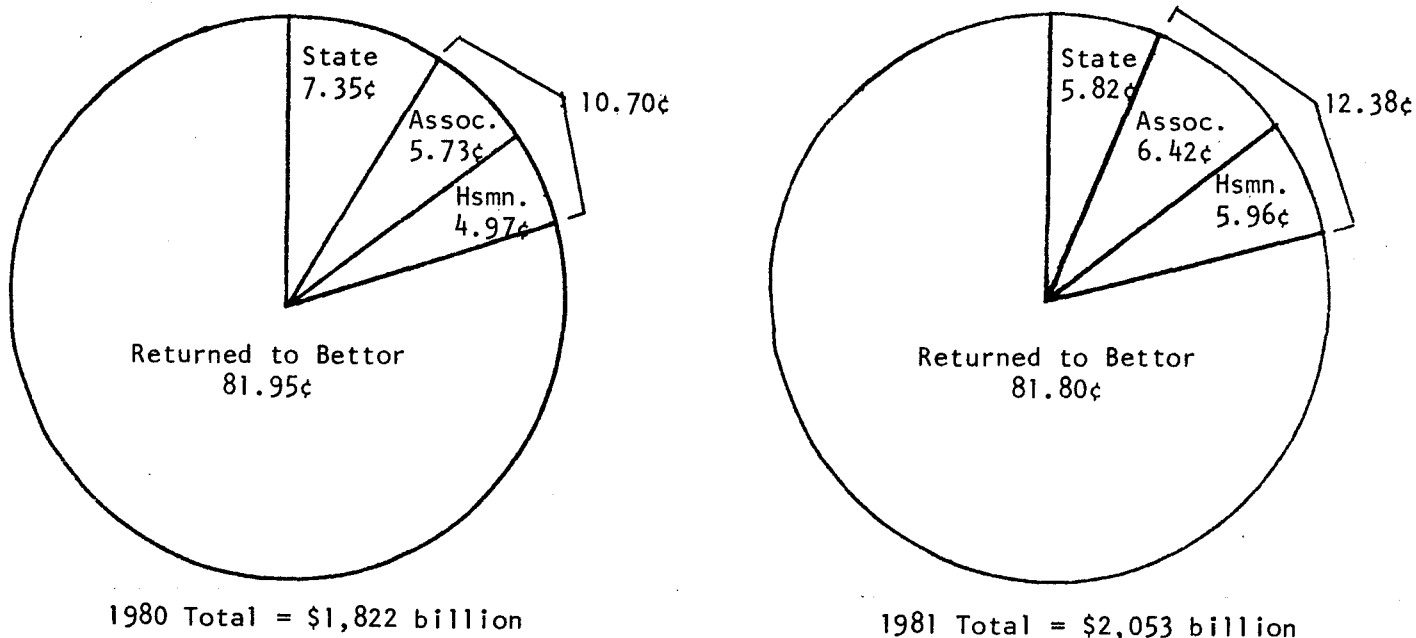
It is conservatively estimated (based on the average 8.09 percent annual growth in wagering between 1971 and 1980, with distribution of an expected \$2 billion handle according to 1980 ratios) that without AB 3383, state racing revenues in 1981 would have been at least \$25 million more than actual revenues. Revenues to associations and horsemen would have been \$43.5 million less. (See Appendix A, Table B.)

Based on the testimony of AB 3383's proponents that Pick-Six wagering (a coincidental CHRB innovation not associated with this legislation) would by itself increase the total handle 10 percent, virtually all the actual growth from 1980 to 1981 could be accounted for without any supposed impetus from AB 3383. The measure, therefore, constituted a giveaway of as much as \$31 million in potential 1981 state racing revenues. (See Appendix A, Table C.)

In summary, the state's share of racing revenue was \$.69 for every dollar paid to associations and horsemen before the advent of AB 3383. Although the measure did not significantly increase wagering activity, it redistributed take out so that the state's share fell to \$.47 for every dollar paid to associations and horsemen. This constituted an extraordinary loss of 32 percent from the relationship that formerly existed--a loss of between \$25 million and \$31 million in expected 1981 state racing revenues.

The distributions of average pari-mutuel dollars wagered in the 1980 and 1981 racing years are graphically presented below. These figures, based on Table A of Appendix A, include distributed breakage. Unclaimed winnings, equivalent to about 13 hundredths of one cent per dollar, are categorized as "returned to bettor" for accounting purposes although their ultimate disposition in 1980 and 1981 is as noted.

FIGURE 1. DISTRIBUTION OF AVERAGE PARI-MUTUEL DOLLAR (100¢) WAGERED IN THE 1980 AND 1981 RACING YEARS<sup>1/</sup>



<sup>1/</sup> Unclaimed ticket revenues totaled \$2,492,617 and \$2,729,203, respectively, in the 1980 and 1981 racing years. In 1980, prior to the enactment of AB 3383, the entire amount reverted to the state. In 1981, however, under the provisions of AB 3383, the state's share was decreased \$1,089,688 to \$1,639,515 while \$1,089,688 went to the Horsemen's Organization Welfare Account.

Table 1.A provides detail about the distribution of breakage included in Table 1 and Figure 1. The state's share of breakage slipped, from \$1.39 for every dollar paid to associations and horsemen before AB 3383 (1980), to \$.64 for every dollar paid to associations and horsemen in 1981 -- a relative loss of 54 percent from the former parity. This constituted a state giveaway of \$3.5 million in potential 1981 revenues. The distribution of total breakage is as follows:

TABLE 1.A  
DISTRIBUTION OF BREAKAGE IN THE 1980 AND 1981 RACING YEARS

<u>Distribution</u>	<u>1980</u>	<u>1981</u>	<u>Change</u>
Total Breakage	\$15,526,252	\$18,391,357	+\$2,865,105
State Revenue	9,018,088	7,149,997	-1,868,091
Assoc. & Hsmn.	6,508,164	11,241,360	+4,733,196
Associations	1,148,043	2,271,671	+1,123,628
Owners	4,577,691	7,268,401	+2,690,710
Breeders	782,430	1,701,288	+918,858

#### Financial Stability of Horsemen and Racing Associations

According to the above Table, AB 3383 substantially increased the revenues apportioned to racing associations and horsemen. The logic behind this dramatic gift was ostensibly based upon a 1979 study performed by Temple, Barker and Sloan<sup>3/</sup> (An Analysis of the California Horse Racing Industry, March 1979) at the request of the CHRB and the Racing Association. This report, funded by the Associations, determined that without substantial financial relief horsemen and racing associations could not continue their involvement in horse racing.

We attempted to review the report's assumptions relative to the financial condition of horsemen. Using their assumptions, we were able to recreate their findings. In order to verify the horsemen's actual financial conditions, however, we would need access to audited financial statements. We were unable to obtain these and consequently cannot offer a definitive comment on the horsemen's financial needs.

The racing associations, on the other hand, are required to file annual financial statements with the CHRB. Using available statements from 1977 to 1981, we performed a financial ratio analysis. Ratios, according to the Field Audits Bureau at the State Controller's office, are among the best known and most widely used tools of financial analysis. A ratio expresses the mathematical relationship between one quantity and another. While the computation involves a simple arithmetic operation, the interpretation is a far more complex matter. Properly interpreted, ratios may point out areas requiring further investigation. The analysis can disclose relationships and trends that cannot be detected by an inspection of raw data in nonratio form.

<sup>3/</sup> Temple, Barker & Sloan is a consulting firm located in Lexington, Massachusetts



Our review included an analysis of liquidity ratios, profitability ratios and performance ratios. Of these ratios, the performance ratios (return on total assets and return on owners' equity) provide the best indication of the overall performance of the associations and their efficacy as investments. These ratios illustrate the earned income for each dollar of total assets and on each dollar of stockholders' (owners) equity.<sup>4/</sup> The ratios can also be converted to a percent if multiplied by 100.

The return on total assets ratio is a general indicator of the overall profitability of the associations' operations. This ratio provides a measure of the earning power of the associations as business entities. It is computed by dividing net income by total assets. The return on owners' equity ratio illustrates the earning power of the funds invested or left in associations by their stockholders. This ratio may be used as a means of comparing associations to other firms, or any investment opportunity, as to profitability and desirability as an investment. It is computed by dividing net income by stockholders' equity.

Table 2 illustrates the return on total assets ratio constructed for 10 major California racing associations for 1977 through 1981. Return on total assets, excluding Golden Bear Raceway, ranged from a low of about .03 or 3 percent (Del Mar-1977) to a high of just less than .30 or 30 percent (Tanforan-1978). The median return on total assets for the period reviewed was approximately .11 or 11 percent. Thus, for every dollar of total assets, the associations earned between \$.03 and \$.29, with a median earnings of about \$.11 per dollar. The return on stockholders' equity displayed in Table 3 ranged from a low of .09 or 9 percent (Los Alamitos Race Course-1979) to 1.12 or 112 percent (Los Angeles Turf Club-1977).

Return on owners' equity appears to be the most significant of the ratios reviewed in relationship to the profitability of the racing associations. To fully understand the impact of these ratios in various years, they should be compared to the returns on equity yield by other industries during the same period.

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<sup>4/</sup> Net income equals gross income less total expenditures. Total assets equal financial resources--including cash, property, and equipment. They do not consider any outstanding obligations such as loans. Stockholders' or owners' equity equals the total investments by stockholders--including original investment and undistributed earnings. It is calculated as total assets less outstanding liabilities (loans).

TABLE 2  
COMPARISON OF RETURN ON TOTAL ASSETS  
MAJOR CALIFORNIA HORSE RACING ASSOCIATION  
1977 - 1981

<u>Association</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
California Jockey Club	.1379	.1581	.2260	.1826 <sup>1/</sup>	N/A
Del Mar Thoroughbred Club	.0320	.1227	.1067	.0426	.0743
Golden Bear Raceway	-.9146	.2852	1.7772	-.1214	.0935
Hollywood Park, Inc.	.0874	.0946	.1108	.1066	.1437
Horsemen's Quarter Horse Racing Assoc.	.2157	.1960	.1090	.1589	.2567
Los Alamitos Race Course	.1064	.0941 <sup>2/</sup>	.0800	.0909	.1351
Los Angeles Turf Club	.2623	.2641	.1274	.0652	N/A
Oak Tree Racing Assoc.	.0881	.2064	.0960	.1277	.1304
Southern California Racing Assoc.	.1152	.1565	.0955	-.0639 <sup>3/</sup>	.0525
Tanforan Racing Assoc.	N/A	.2952	.0762	.2147	N/A

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<sup>1/</sup> Charity expenses are intermingled with the track's other expenses, thus, charity proceeds are included as an expense. Consequently, the operating ratio is understated.

<sup>2/</sup> A note to summary of Revenue and Expenses in 1978 financial report states that subsequent to the preparation of the statement an error was discovered. Track pari-mutuel was understated by \$7,040.99 and charity revenues were overstated by \$7,040.99.

<sup>3/</sup> The net loss included an extraordinary expense item of \$175,000. Net income before this item was \$87,273. This expense involved the transfer of ownership of SCRA to Arnold. Without this expense the operation ratio was .9807, the net profit margin was .0193, the return on total assets was .0639, and the return on owners' equity was .0788.

TABLE 3  
COMPARISON OF RETURN ON OWNERS' EQUITY  
MAJOR CALIFORNIA HORSE RACING ASSOCIATION  
1977 - 1981

<u>Association</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
California Jockey Club	.2146	.2563	.2648	.2653 <sup>1/</sup>	N/A
Del Mar Thoroughbred Club	.1698	.4222	.3139	.1583	.2519
Golden Bear Raceway	<u>2/</u>	<u>2/3/</u>	<u>2/</u>	<u>2/</u>	<u>2/3/</u>
Hollywood Park, Inc.	.1350	.1536	.1536	.1784	.2126
Horsemen's Quarter Horse Racing Assoc.	.2638	.2201	.1341	.1818	.2724
Los Alamitos Race Course	.1226	.1053 <sup>4/</sup>	.0886	.1085	.1572
Los Angeles Turf Club	1.1234	.5832	.3192	.3203	N/A
Oak Tree Racing Assoc.	.0983	.2304	.1089	.1454	.1741
Southern California Racing Assoc.	.1673	.2000	.1234	-.0792 <sup>5/</sup>	.1198
Tanforan Racing Assoc.	N/A	.3975	.4999	.7141	N/A

<sup>1/</sup> Charity expenses are intermingled with the tracks' other expenses, thus, charity proceeds are included as an expense. Consequently, the operating ratio is understated.

<sup>2/</sup> Because total stockholders' equity is a negative number the calculations of the noted ratios would not be meaningful.

<sup>3/</sup> Golden Bear showed a profit in 1978 of \$46,935 and in 1981 of \$21,335. In effect, these profits were made on borrowed money. While this company does not seem to make any money it should be noted this company is owned entirely by the Arnold family and preliminary investigation indicated the Arnolds are paid some type of salary by the company.

<sup>4/</sup> Note to summary of Revenue and Expenses in 1978 financial report states that subsequent to the preparation of the statement an error was discovered. Track pari-mutuel was understated by \$7,040.99 and charity revenues was overstated by \$7,040.99.

<sup>5/</sup> The net loss included an extraordinary expense item of \$175,000. Net income before this item was \$87,273. This expense involved the transfer of ownership of SCRA to Arnold. Without this expense the operation ratio was .9807, the net profit margin was .0193, the return on total assets was .0639, and the return on owners equity was .0788.

TABLE 4  
RETURN ON OWNERS' EQUITY  
SELECTED INDUSTRIES<sup>1/</sup>  
1977 - 1980

Year	Banking	Amusement and Leisure Time	Retail Food	Regulated Investment Companies	Horse Racing Associations <sup>2/</sup>
1977	.057	.060	.089	.050	.1350 - .2638
1978	.029	.026	.086	.045	.1536 - .4222
1979	.088	.039	.079	.045	.1234 - .3192
1980	.088	.058	.077	.052	.1454 - .3203

It is obvious from the comparisons shown in Table 4 that the racing industry is more lucrative than the other selected industries shown. The Racing Associations have major owners who often work for the association. These individuals generally draw a salary in addition to any dividends paid to them as stockholders. These ratios, therefore, do not support the Temple, Barker and Sloan claim. In fact, analysis indicates that in general these racing associations constitute very lucrative investments.

The Temple, Barker, and Sloan report also argued against using the equity of assets held by owner-associations--such as land and fixtures--claiming that it is misleading and overstates the true return, as it does not reflect the current market value of the assets. (The term "equity" refers to the original purchase price and does not allow for appreciation of the assets.) The report conveniently neglects to mention the fact that the appreciation of such assets ensures a higher real return to the owners. In other words, it makes their stock holdings much more valuable should they wish to sell them or liquidate the corporation and sell the land holdings. The fact that the increase in land value is not recognized on their books under generally accepted accounting principles allows them to defer the related tax on the appreciation to some future period and receive preferential tax treatment at that time. The argument by Temple, Barker, and Sloan also ignores the fact that the return on equity is computed in the same manner for all other industries in the United States. When the horse racing industry uses other methods, not generally accepted, to account for return and holdings, this results in misleading financial statements.

In view of these findings, the Commission recommends that the Legislature reconsider their action on AB 3383.

<sup>1/</sup> Provided by the Field Audit Bureau, State Controller's Office.

<sup>2/</sup> Typical returns, from Table 3.

#### IV. THE BOARD'S FISCAL MANAGEMENT PRACTICES

##### Department of Finance Audit

On June 1, 1982, the Department of Finance (DOF) published the findings of its comprehensive fiscal review of the California Horse Racing Board. The review was requested by Senate Finance Subcommittee No. 5 in response to a legislative analyst's report, published in the review of the 1982-83 Governor's Budget. The analyst indicated that the Horse Racing Board had violated an Executive Order, misspent state funds, and still owed the Attorney General (AG) over \$29,000 for 1980-81 attorney services. The review also determined that (1) the board falsified its 1980-81 year statements to the State Controller, and (2) that the board's budgetary and financial practices violated numerous provisions of the State Administrative Manual. (The audit made 45 recommendations to the board's staff.)

Because of the seriousness of the violations and the improprieties discovered by the audit, the Department of Finance is referring the findings to the Attorney General for his review and recommendation as to any potential legal action. The Department is also setting itself up as a conservator over the board's finances. Finance will actively participate in the development of budget allotments and monthly expenditure plans. Once established, the board will have to receive DOF approval in order to alter its allotments and will be required to strictly adhere to the monthly plans. (When preparing budget plans, agencies are required to allot their operating expense and equipment appropriation to subcategories. However, the expenditure of these funds is discretionary, and agencies are free to redirect the allotments to conform with actual expenditures.) Finally, Finance is recommending that the Department of General Services review the board's purchase delegation authority. (Agencies cannot make purchases in excess of \$100 without approval of the Department of General Services. The board currently has authority to make purchases of up to \$500 without General Services' approval.)

The actions taken by Finance are extremely severe and represent a total absence of faith in the CHRB's executive staff. Our analysis of the audit findings and other available information entirely supports the Department's actions, including the involvement of the Attorney General. The Department's action will prevent a future recurrence of the violations. However, the very need of such drastic steps should be a source of extreme embarrassment to members of the Horse Racing Board. The responsibility, therefore, befalls the appointed members of the board to hold their staff accountable and to ensure that all recommendations of the DOF are speedily enacted.

We do not intend to discuss all of the Department's findings, since they are quite numerous. However, a few items bear additional discussion and, coupled with information we have gathered, portray a vivid picture of the board's failure to properly manage its funds.

##### Falsified Reports

According to data supplied by the board and published by the State Controller in his 1980-81 annual report, in 1980-81 the CHRB incurred total

expenditures of \$1,225,756 against an appropriation of \$1,226,571, leaving an unexpended balance of \$815. In January of 1982 the board published its annual report to the Governor. Page 19 of this report presented the CHRB's 1980-81 expenditures. This version showed total 1980-81 expenditures of \$1,255,303 against a budget appropriation of \$1,226,571, indicating that expenditures exceeded revenues by \$28,732. In other words, in 1980-81 the board spent \$28,732 more than the Legislature authorized. It is interesting to note that, based upon information supplied by the Attorney General's office, as of December 1, 1981, the board had outstanding billings from the A.G. totaling \$29,421. These outstanding billings alone were \$689 greater than the \$28,732 in unpaid debts presented in the January 1982 report. On April 9, 1982 the Horse Racing Board published a third version of its 1980-81 budget. According to this version, total expenditures (\$1,259,875) exceeded the budget appropriation (\$1,226,571) by \$33,304.

The Department of Finance audit, fortunately, does clarify this situation. In reference to the report filed with the State Controller, the audit states, "our tests of the accuracy and validity of the accounts payable accrual revealed that the CHRB failed to accrue all valid payables so as not to show a budget deficit." In simple terms, the board purposely misstated its financial situation and falsified its report to the State Controller. The audit further states that the CHRB's actual 1980-81 expenditures exceeded the budget appropriation by \$37,382.<sup>5/</sup>

When questioned about the year-end report filed with the Controller, the board's manager of administrative services said that the expenditures were knowingly understated because they did not want to report an over expenditure of their budget appropriation. The variance between the other reports published by the board and the Finance audit, explained by the manager, were a result of A.G. billings for the 1980-81 year that were received in January of 1982.

A review of A.G. billing records does indicate that two 1980-81 bills totaling \$1,200 were sent in January of 1982. The total, though, does not account for the \$4,572 difference between the financial reports issued by the board in January and April or the additional \$4,078 in expenditures uncovered by the DOF.

#### Misexpenditure of Government Funds

In the 1982-83 analysis of the Governor's Budget, the Legislative Analyst reported that the California Horse Racing Board had unpaid bills from its 1980-81 fiscal year totaling \$29,421. In addition, the analyst indicated that the board had disregarded Executive Order D80-71, violated Section 13324 of the Government Code, and misspent \$28,218 given to it expressly for payment of Attorney General fees. The Department of Finance's audit confirmed the analyst's findings and determined that the board's actual, unpaid 1980-81 debts were \$38,196.

<sup>5/</sup> Actual unpaid billings totaled \$38,196. There was an \$814 unexpended balance in the Personnel Services account. Thus, total expenditures exceeded total revenues by \$37,382. It is unknown though, whether the \$814 will be applied to the \$38,196 in unpaid billings.

In support of its action the board claims that there was no "moral culpability." The Executive Secretary ventured that the money, though not spent on A.G. fees, was spent on other legitimate operating expense and equipment (debt) items. Although Finance's audit verifies that the funds were spent on OE&E expenses, it still leaves the larger question unanswered. Why did the board's staff feel they could disregard an Executive Order expressly granted for payment of Attorney General fees? (In June, 1981, the CHRB estimated total 1980-81 A.G. fees to be \$82,764. Actual 1980-81 billings total \$84,442.) If the funds were misspent by accident, as the Executive Secretary claimed, why did the board wait until January of 1982--six months after Finance had granted the emergency payment--to inform the Department?

The first indication the DOF had that something was amiss came in October of 1981 when the board's staff requested another augmentation of \$29,547 to cover unpaid 1980-81 Attorney General fees. It was only after repeated requests by Finance for an explanation that the board's staff confessed to the misexpenditure of funds. A review of the facts seems to indicate that the board's staff was not eager to confess their guilt. In fact, if it had not been for the work of the legislative analyst and the persistent inquiries of the DOF, it is doubtful that the CHRB's staff would have ever admitted disregarding the Executive Order, violating the State Government Code, and misspending \$28,218 in state funds.

#### Investigative Position

The CHRB requested, and the Department of Finance approved, two new investigator positions to be included in the board's 1981-82 budget request. Inadvertently, however, the budget request submitted to the Legislature only contained sufficient funding for the salary of one of the two requested positions. The Legislature approved the two positions but did not adjust the funding.

During the preparation of the 1982-83 budget, the Department of Finance directed the board's staff to add \$30,000 to its base line budget in order to properly fund the two investigator positions. Since the CHRB members and its executive staff have adamantly complained that they are understaffed, one would assume they would not hesitate to so easily increase their staff. For some reason, though, the board's executive staff failed to add the additional funds. Thus, for the second year in a row, the board was authorized to hire a new investigator but was unable to do so due to the lack of funds.

#### Expenditure of Stewards' Funds

On April 15, 1981, the CHRB issued a warrant on its revolving fund made out to Hastings Camera Shop for various photo supplies. According to Hastings Camera Shop, the film purchased was a high speed, sensitive type used at the tracks for horse identification photographs. (Identification photographs are taken of all race horses and used by the official horse identifier to positively identify each horse before it is allowed to race.) When questioned about the purchase the board indicated that the expenditure had been charged to the Stewards' Compensation Fund and that the photo supplies were part of a new training program.

Stewards are contract employees authorized by the board to supervise racing meetings. The board assesses each racing association for stewards' services and deposits the assessment in a special steward compensation account within the State Treasury. The board is authorized under state law to issue warrants against these funds for payment of steward salaries, wages, and benefits.

Further questioning revealed that the supplies were used to develop a training film for stewards. When we asked if we could view the film, we were told that the supplies were actually used for a new experimental horse identification program.

We asked the board's Executive Secretary why stewards' funds had been used to purchase the film. The Executive Secretary indicated that the Department of Finance authorized the board to assess the stewards' fund for administrative expenses related to the stewards' program. The Secretary then stated that the stewards were responsible for overseeing the official horse identification program at the tracks and thus it was appropriate to bill the stewards' fund for the film. Further investigation indicated that the Executive Secretary was correct in that stewards do oversee the horse identification process. However, stewards are similarly responsible for the board's investigative and licensing programs at each track.

Consequently, based upon the Executive Secretary's logic, the CHRB could presumably assess the Stewards' Compensation Fund for the total costs of the board's licensing and investigation programs. In our opinion, use of stewards' funds for these purposes, as well as the purchase of the film, is unlawful.

#### Budgetary Controls

The State Administrative Manual (SAM) requires state agencies to allocate their budget appropriations into two major categories--the Personal Services Account and Operating Expense and Equipment Account (OE&E). The Personal Services Account is used for the salaries and benefits of the agencies' employees, and the OE&E account provides support such as office supplies, telephone equipment, travel, per diem, and other related expenses. One of the basic purposes of such a division is that agencies will be forced to forecast in detail their proposed expenditures and then live within these forecasts. The SAM manual does provide, however, for categorical transfer between the two accounts upon approval of the Department of Finance. This provision, for example, allows agencies to take advantage of an unplanned surplus in the personal services account to meet unforeseen increased costs in the OE&E account. The assumption, though, is that the request of such transfers would be an option of last resort.

A review of the record indicates that the CHRB chronically augments its OE&E account through the categorical transfer of funds from its personal services account. Table 5 below presents the board's categorical transfers that we were able to document occurring during 1977-78 through the 1981-82 fiscal year. In addition to these transfers the board also received an emergency augmentation of \$31,672 in 1977-78 for additional costs associated with an increase in racing days and of \$37,600 in 1980-81 for an unplanned increase in Attorney General services.



TABLE 5  
CATEGORICAL TRANSFERS

Fiscal Year	Reason Provided by CHRB Necessitating Transfer	Fiscal Years 1978-79 to 1981-82			Month Approved by DOF	Total Transferred During Fiscal Year
		Amount Transferred	Money Transferred From	Money Transferred To		
1977-78	Pay Additional Attorney General Fees <sup>1/</sup> Interstate Information Services <sup>2/</sup> and Communications	\$12,000	Personal Services	OE&E*	7/76	\$12,000
1978-79	Pay General Office Expense Interstate Information Services, Legal Hearings, Fingerprint Fees	\$25,000	Personal Services	OE&E	5/79	
	Payment of Unpaid OE&E Expenses	\$ 3,500	Personal Services	OE&E	10/79	
	Payment of Outstanding OE&E Expenditures	\$ 2,000	Personal Services	OE&E	2/80	\$30,500
1979-80	Pay AG Fees, Legal Hearings, Track & General Office Expenses	\$50,000	Personal Services	OE&E	7/80	\$50,000
1980-81	Payment of AG Fees & Legal Hearings	\$15,000	Personal Services	OE&E	6/81	
	Payment of Hearing Office Costs & Fingerprint Fees	\$ 4,000	Personal Services	OE&E	7/81	\$19,000
1981-82	Payment of Increased Rent, Fingerprint Fees, & AG Fees	\$72,582	Personal Services	OE&E	3/82	\$72,582
TOTAL TRANSFERS, 1977-78 - 1981-82		\$184,082				

<sup>1/</sup> The Attorney General is designated by law as the Board's Council and thus represents the Board in any legal disputes arising from the regulating of racing.

<sup>2/</sup> Interstate information service provides data on the Board's licensees' racing involvement in other states.

\* Operating Expenses and Expenditures Account.

TABLE 6

## CALIFORNIA HORSE RACING BOARD

## Salary Savings

Fiscal Years 1977-78 to 1981-82

	<u>1977-78</u>	<u>1978-79</u>	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>
Categorical Transfers From Personal Services Account	\$12,000	\$30,500	\$50,000	\$19,000	\$72,582
Unexpended Year-end Balance In Personal Services	-	\$35,638	\$34,000	\$ 815	\$16,000 <sup>1/</sup>
Reductions for Salary Savings - Added to Budget by the Legislature	-			\$20,000	\$31,913 <sup>2/</sup>
Total Salary Savings	\$12,000	\$66,138	\$84,000	\$39,815	\$120,495
Total Personal Services	\$993,416	\$1,300,689	\$1,190,330	\$1,753,000	\$1,986,000 <sup>1/</sup>
Total Salary Savings as a Percentage of Total Personal Services	1.21%	5.08%	7.06%	2.27%	6.07%

<sup>1/</sup> Estimated by the Department of Finance<sup>2/</sup> The CHRB's budget request included \$1,913 in estimated salary savings, the Legislature increased that amount by an additional \$30,000.

State agencies are required, when preparing their budgets, to provide some estimate of salary savings. Experience shows that agencies accrue salary savings for a number of reasons, including leaves of absence, vacant positions, delays in filling new positions, or filling positions at the minimum step of the salary range. The estimate is provided, therefore, to forestall overbudgeting.

Generally the CHRB's budgets, as submitted to the Legislature, have failed to provide for any salary savings. The information presented in Table 6 shows, however, that the board has experienced surpluses in its personal services account. Between 1977-78 and 1981-82 (as discussed above) the board was able to transfer \$184,000 in surplus funds from its personal services account to its operating expenses and equipment account. Specifically, in 1977-78, 1978-79, 1979-80, 1980-81 and 1981-82, the CHRB, by using surplus funds in its personnel services account, increased its operating expenses and equipment appropriation (as enacted by the Legislature) by at least \$184,082. In addition to the transfers, the board also finished the 1978-79 and 1979-80 fiscal years with unexpended balances in its personal services account of \$34,638 and \$34,000, respectfully.

The Legislature, in an attempt to control for salary savings, reduced the board's 1980-81 budget by \$20,000 and its 1981-82 budget by \$30,000. Even with these reductions, the board was still able to transfer \$19,000 in 1980-81 and \$72,582 in 1981-82 from its personal services account. The data reveal a trend in the board's budgeting practices, namely a clear pattern of using surplus personnel funds to support operating expenses and equipment expenditures. The CHRB is thus able to circumvent the intended purpose behind the categorical division of its budget.

The CHRB claims the transfers indicate that the board's basic OE&E budget is insufficient to properly support all of the board's programs. While there may be some expenses over which the board has little control, our analysis indicates that the board generally has failed to exercise proper control.

The Department of Finance audit disclosed a number of board practices that translate into increased state costs. The audit revealed that the CHRB has not performed a lease/purchase analysis, required by SAM, on several pieces of office equipment currently being rented. (These include a copier machine, portable computer terminals, a micro-disc processor and some typewriters.) The State Administrative Manual also requires agencies to obtain at least three competitive bids for all equipment rentals and hearing reporter services. The auditors could find no evidence that the board had complied with this provision either.

In addition, the audit determined that orders with private vendors were being made verbally; reimbursable travel was not conducted in the most economical fashion; and items purchased from Central Stores were being picked up by board employees--adding employee time and travel costs to an original purchase price that includes delivery by General Services.

In sum, the California Horse Racing Board has ignored the basic budgeting practices outlined by the state--practices that, if followed, would ensure

the acquisition of the best service at the least cost. It is also apparent that the CHRB has failed to show proper planning, constraint or control over its expenditures, resulting in unnecessary costs and inefficient use of the board's resources and state funds.

## V. THE BOARD'S MANAGEMENT OF THE RACING INDUSTRY

### Stewards' Decisions

Under the provisions of the State Horse Racing Law, the CHRB is expressly charged with the responsibility of regulating Horse Racing in California. The board is specifically directed to ensure uniformity in the regulation of the various types of horse racing and participants' conformity to rules, regulations and state laws. Consistent with this charge, the board contracts with stewards who, working in teams of three, act as umpires at the race tracks, and supervise all aspects of the race meetings. The stewards are empowered by the board to enforce all appropriate rules, regulations and laws, and to adjudicate any disputes arising from the misconduct of licensees. In this quasi-judicial role the stewards are authorized to suspend occupational licenses, to impose fines, and to restrict access to racing facilities. The board does have other enforcement tools, such as its investigative staff and its licensing process, that support the stewards. The licensing process allows the board to screen racing participants and to eliminate unsavory individuals. The investigative staff, structured similar to other police and crime prevention units, patrol race tracks and investigate potential violations under the direction of the stewards.

The licensing and investigative procedures, therefore, play a vital role in the board's enforcement program. However, it is the stewards and their authority to impose fines and other punitive measures that constitute the backbone of the program. Clearly, if the punitive measures are levied inconsistently or do not pose a sufficient deterrent, then the entire enforcement system rapidly deteriorates and is of little value.

Prior to December, 1981, the board limited stewards' rulings to a maximum fine of \$500 and a maximum 6-month suspension of a license. Since the change, the stewards have levied several fines in excess of \$500 and suspended licenses for more than 6 months. The majority of their punitive decisions, however, still fall below the old maximums. Our review indicates that in many instances these fines do not pose a sufficient deterrent. For example, we found numerous rulings fining veterinarians for failure to properly medicate or report medication of horses. The fines ranged from \$100 to \$500, which on the surface appears to be quite significant. In view of their earning capacity, a \$500 fine does not seem so substantial.

We also found rulings against two pari-mutuel clerks who were fined \$100 each for wagering during working hours in violation of CHRB rules. One of the clerks won \$769 on a \$2 Daily Double Ticket and the other cashed an exacta ticket worth \$2,273.50. The only reason these two were caught was that they had to sign an IRS tax form required of all winners of \$500 or more. Otherwise, the violations would have gone undetected. The stewards fined each of the clerks \$100, a small sum in comparison to the clerks' winnings.

Our review further indicated that the punishments assessed for specific types of violations are not consistent and may vary depending on the type of racing being conducted. Typically, we found that fines at thoroughbred meetings were more severe. At the same time, we were unable to locate any

rulings against racing associations. We asked the board's Executive Secretary about the findings and he expressed no surprise. He indicated that the staff had made numerous attempts to give the stewards direction and had even suggested that the board establish uniform punitive guidelines for the stewards. The stewards, according to the Executive Secretary, were able to convince the CHRB members that such action was not necessary. We, on the other hand, can see no valid reason for not establishing such guidelines. The guidelines should set parameters of a minimum and a maximum penalty for each type of violation. The stewards would then be free to assess penalties consistent with the board's opinion. Rather than diminishing stewards' authority, the guidelines would enhance their authority and reduce the number of stewards' decisions appealed to the board. In addition, the guidelines would ensure uniformity between the types of racing and could ensure that the penalties are severe enough to constitute a deterrent.

Consequently, based upon our review, we strongly recommend that the CHRB establish some form of mandatory uniform guidelines for the stewards.

#### Occupational License Fees

Current law authorized the CHRB to require all racing participants to purchase an occupational license. The board has established over 25 different license categories with fees ranging from \$20 (a groom or stable employee) to \$250 (a partnership or syndicate). According to the Department of Finance and the board's Executive Secretary, the occupational license fees are structured to generate enough revenue to support the board's licensing and field operation programs. (Any monies appropriated to the board by the Legislature from the Fair and Exposition Fund or the race track security account, reduce General Fund racing revenue by the amount of the appropriation.)

Beginning in January of 1979, the CHRB moved from a one-year licensing period to a three-year licensing period. Although the initial fees for the new three-year licenses were increased, on an annualized basis the fees were generally reduced. For example, in 1978 the annual license fee for a stable name was \$100. Currently, under the structure enacted in 1979, the three-year fee for a stable name license is \$250 which equates to an average annual fee of about \$83 or \$17 less than the 1978 annual fee. The current license fees, on an annual basis, actually are less than the annual fees levied by the board in 1975. Fortunately the number of licensees has grown and, as a result, total fee revenues have somewhat kept pace with the board's licensing and enforcement expenditures.

The board, in response to a directive from the Department of Finance, is currently in the process of increasing the license fees. The proposed increase will supposedly be structured to provide enough additional revenue to cover an increase in the cost of processing fingerprints for all applicants. Even with the proposed increase, on an annual basis, the various license fees will be only at or slightly above their 1978 levels.

The Executive Secretary and several board members claim that--due to the increase in licenses issued and racing days--the board, at current staff levels, is unable to properly supervise its licensees. Furthermore, the

board claims that its requests for increased staff have been repeatedly turned down by Finance. None of the board's proposals, however, included any level of increase in occupational license fees.

Conversations with the Department of Finance indicate that any proposed increase in the board's expenditures--such as an increase in licensing or field staff--accompanied with an offsetting increase in General Fund revenue (an increase in occupational license fees) would receive Finance's approval and support before the Legislature.

Accordingly, we recommend that the California Horse Racing Board off set any proposed increase in licensing and/or field staff with an increase in the board's occupational license fees.

#### Charity Racing Money

The State Racing Law requires each racing association to conduct charity racing days and to donate the net profits to charity. The law specifies that associations conducting 14 or less weeks of racing (other than fairs) must designate three charity racing days and those conducting in excess of 14 weeks of racing must designate five charity racing days. Racing associations are required to contribute the net revenue collected on charity days to a fiscal agent (known as a charity foundation) for dispersal to charities. (See Table 7 below.)

The Auditor General, in his review of the CHRB, made several recommendations relative to charity racing days. The Auditor General found that under the current administrative procedures, the board was unable to ensure that racing associations fully comply with the law and contribute the correct amount to the designated charity foundations. In addition, it was determined that the board was unable to verify the distribution of the charity monies by the charity foundations. In response to the recommendations, the board is currently adopting rules requiring charity foundations to file timely, audited financial statements and recently adopted a similar rule governing racing associations.

In our review of the audits on file at the board, we found great variance in their organization and format, making financial comparisons difficult and in some cases impossible. Thus, we recommend that the board adopt strict guidelines requiring consistency in the organization and format of the various audited statements submitted.

The State Racing Law also directs racing associations to pay the charity revenue to the various charity foundations "as soon as practicable after the determination thereof."<sup>6/</sup> Even though the language is vague, our review indicates that most associations are making timely payments. Unfortunately, the vagueness of the language does lend itself to personal interpretation. We found that \$676,000 in charity race revenues collected by one Southern Thoroughbred Racing Association during its meet--conducted between April and the end of July in 1980--was not dispersed to the charity foundations until May of 1981. Because of the law governing the cashing of pari-mutuel tickets (tickets may be redeemed at tracks within 60 days of

<sup>6/</sup> Section 19555, Chapter 4, Division 8, Business and Professions Code.

TABLE 7  
CHARITY RACING<sup>1/</sup>

Calendar Years 1975 to 1981

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Charity Racing Days	50	52	53	58	53	49	55
Net Charity Racing Proceeds <sup>2/</sup>	\$1,404,373	\$1,260,821	\$1,301,945	\$1,371,947	\$1,589,740	\$1,938,638	\$1,341,315
Average Daily Charity Proceeds <sup>2/</sup>	\$28,087	\$24,247	\$24,565	\$23,654	\$29,995	\$39,564	\$24,388

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<sup>1/</sup> The California horse racing associations, as a condition of license and as specified by the Horse Racing Law, Sections 19550-19557, are obligated to conduct a specified portion of their race meetings for charity with all profits from charity days operations dedicated for charitable purposes. Each racing association obligated to conduct charity day racing establishes a charity foundation whose members may not be connected with the racing association and who must be a member of a governing board of an organization engaged in civic, religious, charitable, educational or veteran activities in this State. On charity racing days the racing association furnishes its plant, facilities and all personnel and property necessary for the conduct of racing. The income for all operations of the race meeting, less deductions for actual expenses (but not overhead expenses which would be incurred irrespective of the conduct of the racing), is paid over by the licensee to the designated distributing agent - the charity foundation. Within twelve months of the receipt of the charity proceeds, the charity distributing agent distributes not less than 90% of the funds to charities meeting the statutory criteria and approved by the Board.

<sup>2/</sup> Net charity racing proceeds and averages for 1978-1981 are based on year of distribution.



the meets closing, after 60 days redemptions are handled by the state), we could understand waiting 60 days to disperse the money. But to wait over 9 months seems a little extreme. Assuming the association invests its idle funds, and based upon the 1980-81 average Pooled Money Investment Rate, we estimate that the Association earned, over this 9-month period, approximately \$50,000 in interest income on the charity monies. As of May of 1982, this same association had not dispersed charity monies collected at its November 1981 meet. This activity is entirely inappropriate, and constitutes a violation of the State Racing Law. Therefore, we recommend that the Legislature clarify existing law and require racing associations to make timely payments of charity monies to charity foundations. Until such time as the law is clarified, we recommend that the California Horse Racing Board sufficiently monitor the associations to ensure the prompt and timely payment of charity monies to charity foundations.

#### Inadequate Security Deposit

Each racing association conducting a racing meet is required, under current law, to deposit \$10,000 with the State Treasurer as security against payment of its state racing fees. In a 1976 report on the Horse Racing Board, the Auditor General commentee on this deposit and in part said,

"This \$10,000 deposit requirement has been part of the Horse Racing Law since its enactment in 1933, and is obsolete in terms of today's billion dollar horse racing industry. Currently associations are required to remit their pari-mutuel license fees on a weekly basis. These weekly deposits for some associations exceed \$1 million, which means a \$10,000 deposit to secure the payment of these fees is totally inadequate. Clearly, the \$10,000 deposit has outlived its usefulness."<sup>7/</sup>

There has been substantial growth in the horse racing industry since 1976. AB 3383 legislated an increase in total racing days and an increase in the number of days per year an association may conduct racing. In 1981, the inaugural year of this bill, the total handle was in excess of \$2 billion with some racing associations experiencing daily handles in excess of \$4 million. Obviously, in the words of the Auditor General, this \$10,000 security deposit has "outlived its usefulness" and is "obsolete." In 1976, the Auditor General suggested the adoption of a performance bond equal to at least 15 days worth of state license fees. (Fifteen days is the minimum notice time a racing association must give the board before prematurely terminating a racing meet.) This proposal would vary the fee depending on the estimated daily handle of the race meet and would protect state racing revenues.

We concur with the 1976 suggestion of the Auditor General and recommend that the Legislature require racing associations to post performance bonds equal, at a minimum, to at least 15 days worth of State License Fees.

<sup>7/</sup> The California Horse Racing Board: A Comprehensive Review of Its Operation. Office of the Auditor General, Report 280, September 27, 1976, pg C-3

### Payment and Deposit of State License Fees

Under the current provisions of the Business and Professions Code, racing associations are required to pay their license fees to the state on a weekly basis. (Prior to 1971 license fees were paid on a daily basis.) While the law does define a racing week to be seven consecutive days, it does not specify the day this payment is to be made. The CHRB, pursuant to its regulatory powers, has determined that a racing week begins on Sunday and ends on Saturday. The major racing meets typically race 5 or 6 days a week and are closed or "dark" on Mondays and Tuesdays.

According to the CHRB's staff, the various racing associations have been directed to make their weekly license fee payments on the first racing day (excluding Sunday) in the week following collection. Since Mondays and occasionally Tuesdays are dark days, the board's staff asserts that most racing associations make their payments on Tuesdays or at the very latest on Wednesdays. The board, as directed under current law, is required to deposit these revenues on the day they are received into the state trust system, thereby making them available for immediate investment with other state funds by the Pooled Money Investment Board. Due to the dearth of information, we were unable to determine the actual days on which the association makes these license fee payments to the board. However, we were able to ascertain, for the current year, the days on which the board deposited funds in the state trust system.

Between July 1, 1981 and March 31, 1982 the board made 127 deposits of \$100,000 or more (See Table 8 below) totaling about \$85 million. (The board's manager of administrative programs indicated that deposits of this size represented state license fee revenues.) Of this \$85 million in deposits, only \$33.5 million, or 39.5 percent, was deposited on Tuesdays or Wednesdays. The remaining \$49.6 million, or 58.4 percent, was deposited on Thursdays and Fridays. We were unable to determine whether the late deposits indicate late payments by the associations or the board's failure to make timely deposits. Either way, this depositing pattern cost the state between \$18,000 and \$34,000 in interest earnings during the first nine months of fiscal year 1980-81 (assumes an 11 percent average yearly interest rate). Furthermore, if this pattern was continued for the remainder of the fiscal year, we estimate a total annual loss in state interest earnings of between \$28,000 and \$50,000.

We also determined that, if the Horse Racing Board required associations to make their weekly license fee payments on Mondays, and if the board made prompt and timely deposits, that 1981-82 state interest earnings would have increased by about \$100,000.

We recommend that, as long as racing associations are required to pay on a weekly basis, that the California Horse Racing Board require those payments to be made on Mondays. We also admonish the board, whenever possible, to deposit these monies on the day of receipt.

State racing law requires associations to pay license fees based upon daily pari-mutuel wagering activity. Consequently, the association generally knows by the end of the day what the state licensee fee obligation is for

TABLE 8

TOTAL DEPOSITS OF \$100,000 OR MORE BY CHRB  
 INTO THE STATE TRUST SYSTEM BY DAY<sup>1/</sup>  
 July 1, 1981 - March 31, 1982

<u>Month</u>	<u>Monday</u>	<u>Tuesday</u>	<u>Wednesday</u>	<u>Thursday</u>	<u>Friday</u>	<u>Monthly Total</u>
July, 1981	\$ 308,692	\$3,286,626	\$1,219,332	\$6,681,893	\$ 792,913	\$12,289,406
August, 1981	-	\$ 295,727	\$ 649,293	\$6,211,600	\$ 154,335	\$ 7,310,955
September, 1981	\$ 617,390	\$ 938,662	\$ 777,948	\$4,261,625	\$1,013,625	\$ 7,608,841
October, 1981	\$ 321,362	\$1,314,197	\$1,346,154	\$3,252,019	\$ 932,557	\$ 7,166,289
November, 1981	\$ 385,883	-	\$2,782,570	\$6,496,099	-	\$ 9,664,552
December, 1981	-	\$2,260,010	\$1,734,008	-	\$2,799,164	\$ 6,793,182
January, 1982	-	\$2,231,515	\$4,859,865	\$1,705,873	\$1,734,444	\$10,531,697
February, 1982	\$ 143,355	\$ 568,470	\$ 928,982	\$4,640,671	\$4,553,157	\$10,834,641
March, 1982	-	\$2,038,523	\$6,337,855	\$4,431,755	-	\$12,808,133
Totals	\$1,776,632	\$12,933,736	\$20,636,007	\$37,681,535	\$11,979,786	\$85,007,696
Percent of Total Deposits	2.09%	15.22%	24.28%	44.33%	14.09%	

<sup>1/</sup> Total Deposits counted - 127.

that day's racing activity. Under the current law, the associations are allowed to hold state revenues for 3 to 13 days before remitting them to the state. These funds are obviously being invested by the associations, and we can see no reason why they should be allowed to earn interest on state monies. Our analysis indicates that, if associations had been required to pay on a daily basis for the entire 1980-81 fiscal year, the state would have experienced an increase in interest earnings of between \$150,000 and \$200,000.

In a 1976 report entitled The California Horse Racing Board: A Comprehensive Review of Its Operations the Auditor General recommended that racing associations be required to remit state license fees on a daily rather than on a weekly basis. It was estimated that daily remittance would have generated about \$44,000 in additional interest income to the state.<sup>8/</sup>

We again concur with the Auditor General and recommend that the State Racing Law be amended to require Horse Racing Associations to pay state license fees on a daily rather than a weekly basis.

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<sup>8/</sup> Ibid pp B-15

## VI. FINDINGS OF THE AUDITOR GENERAL

In an attempt to acquire as much pertinent information as possible, we commissioned the Auditor General and his staff to conduct a Performance and Financial Audit of the Horse Racing Board. The Auditor General's review was directed towards three areas: 1) The licensing investigation and enforcement action conducted by the CHRB's staff and employees; 2) The supervision and administrative enforcement of the racing meetings by the racing officials; and 3) The auditing and accounting procedures used to ensure the integrity of the pari-mutuel operations.

On completion of the study in March of 1982, the Auditor General issued a report and said in part:

"We reviewed both the operations of the board and its financial records, using performance and financial audit techniques to evaluate the adequacy of the board's supervision of horse racing activities. We found that the board needs to improve procedures for monitoring and controlling certain critical activities in horse racing. Specifically, we found that the board has not established comprehensive guidelines for the auditing of pari-mutuel wagering activities. As a result, pari-mutuel audits do not include certain important steps that are necessary to provide the board adequate assurance that revenues are reported accurately.

"Also, the board does not require racing associations to submit an audited statement of charity race day revenues given to charity foundations for distribution to charitable organizations. Further, although the board does require charity foundations to submit audit reports, only one-half of these reports were available for our review for calendar year 1980.

"We also found that the board has no formal system for monitoring the quality of testing conducted by its official racing laboratory. As a result, the board has no assurance that testing is conducted accurately and that racing participants are adhering to the board's drug and medication regulations.

"Further, board staff have not fully defined the role and duties of the board's investigators. As a result, some important enforcement activities are receiving less investigative attention than the board members believe they should.

"Finally, the board has not fingerprinted all applicants to enable the California Department of Justice to conduct investigations of criminal background. As a result, there is the potential for licensing persons who would not be allowed to participate in racing because of prior criminal convictions.

"To improve its regulatory control of horse racing activities, we recommend the California Horse Racing Board adopt certain measures. To ensure that the state revenues are correct, the board should develop, implement, and maintain standardized guidelines for the audit of pari-mutuel operations. In addition, the board should also improve the standardized guidelines for the audit of pari-mutuel operations. In addition, the board should also improve the monitoring of charity race day proceeds by requiring audit reports to verify that proceeds have been calculated correctly and distributed properly.

"We also recommend that the board improve procedures for enforcing certain horse racing laws and regulations. The board should improve the enforcement of drug and medication regulations by developing and implementing a quality control program to assess the work of its official racing laboratory. The board should also fully define the role and duties of its investigators by developing detailed duty statements and procedural manuals. The board should also improve its licensing activities by ensuring that all applicants for licenses are fingerprinted."

In response to these recommendations the CHRB has: 1) agreed to pursue funding for an additional position to monitor the pari-mutuel operations; 2) begun the process of adopting rules requiring the timely filing of audit statements by charity foundations. (The board has already adopted a similar rule governing racing associations); 3) initiated the process of increasing its occupational license fees to cover the cost of fingerprinting all applicants; and 4) initiated the development of detailed duty statements for investigation positions, a new investigators' manual, and a licensing operations manual.

Two of these recommendations, fingerprinting of applicants and the monitoring of pari-mutuel operations, were included in the Auditor General's 1976 report on the Horse Racing Board. The CHRB did attempt, in 1978-79, to get a new position expressly to monitor the pari-mutuel operation. The position, though, was a casualty of Proposition 13. No attempt has been made since that time to acquire the position. We feel the Auditor General's recommendations are of value and, if implemented, could greatly improve the board's ability to properly manage the racing industry. Accordingly, we recommend that the Auditor General closely monitor the progress of the California Horse Racing Board to ensure compliance with all of the Auditor's recommendations.

VII. CALIFORNIA EXPOSITION AND STATE FAIR'S CONTRACTS WITH  
LLOYD ARNOLD FOOD SERVICE AND GOLDEN BEAR RACEWAY

In response to our request, the Controller's Office, Division of Audits, audited the contracting procedures of the California Exposition and State Fair--specifically the current contracts between that entity, Lloyd Arnold Food Service, and Golden Bear Raceway.

California Exposition and State Fair Contracting Procedures

The contracting procedures in effect at Cal Expo are in general compliance with the State Administrative Manual (SAM). However, the review found several instances of non-compliance with individual SAM requirements. These include:

- Failure to evaluate proposals prior to eliminating competing bidders and awarding the contract.
- Failure to award and execute contracts in a timely manner.
- Failure to secure Department of Finance and/or Department of General Services approval prior to commencement of the contract.

We know of no legislative act or administrative ruling which allows Cal Expo to disregard the provisions of the State Administrative Manual. The provisions of the State Administrative Manual are designed to protect state interests. Failure to adhere to these provisions could result in decreased state revenues. Accordingly, we recommend that the California Exposition and State Fair bring its contracting procedures into closer compliance with the provisions of the State Administrative Manual.

Lloyd Arnold Food Service Contract with California Exposition and State Fair

The Lloyd Arnold Food Service (LAFS) Contract is in the form of a lease agreement covering the Turf Club Restaurant and lounge and eleven other concession stands within the grandstands. Rent is set by the agreement as a percentage of gross revenue for the various concessions. Table 9, below, shows the various rates and accompanying total fees paid to the state by Lloyd Arnold Food Service in 1979-80 and 1980-81 fiscal years.

TABLE 9  
LLOYD ARNOLD FOOD SERVICE LEASE RATES AND TOTAL FEES

<u>Concession</u>	<u>Lease Rate as Percent of Gross</u>	<u>Revenue to State</u>	
		<u>Fiscal Year 1979-80</u>	<u>Fiscal Year 1980-81</u>
Turf Club	8%	\$ 8,825	\$ 7,566
Tobacco Stands	12½% } Other Concessions 25%	82,841	68,503
Total		<u>\$ 91,639</u>	<u>\$ 76,069</u>

Rentals are paid based on Statements of Gross sales prepared by the concessionaire. However, the contract only requires the concessionaire to pay rent during State Fair pari-mutuel racing. It allows the concessionaire to use the facilities throughout the entire year--including during the harness racing meet (conducted by Lloyd Arnold's Golden Bear Racing Association) and any other interim events. Thus, the contract requires rent to be paid for the 14-day State Fair Racing Meet but otherwise allows free use of the facilities--such as during the 39-day harness meet conducted by the Golden Bear Raceway in 1981.

In 1980 and 1981, the LAFS paid Golden Bear Raceway \$176,748 and \$139,630, respectively, for the right to operate the food concessions during the harness meet. These payments are peculiar because the state contract expressly authorizes Lloyd Arnold Food Service to operate these concessions during the racing meet.

In discussions with Golden Bear Raceway management, the reasons for such fees were explained as: (1) It is a standard industry practice for concessionaires to pay a fee to race promoters; and (2) It is a means to transfer capital from one profitable Lloyd Arnold enterprise to one that is not profitable.

In general, food concessionaires contract with the association conducting the race meeting. Payments from the concessionaire to the association are therefore appropriate. In this case, however, the concessions contract is with the racing facility (Cal Expo) and does not involve the racing association (Golden Bear). These payments are not required under the contract and appear to be, as Golden Bear management explained, simply a means of transferring capital between two of Lloyd Arnold's enterprises.

#### Golden Bear Raceway Contract With California Exposition and State Fair

The Golden Bear Raceway contract is basically a lease agreement between the California Exposition and State Fair and Golden Bear Raceway (GBR), a California corporation which is wholly owned by Lloyd F. Arnold. The lease covers the race track, grandstands, parking lots C and D, and the backstretch area of the track including the stables. The use of these facilities is limited to the night harness racing meets conducted by Golden Bear Raceway plus ten days before and after such meets for preparation and clean up.

The contract provides year-round office space (approximately 1,000 square feet) at \$1,000 per year, or about \$.08 per square foot per month. Similar office space near Cal Expo would cost GBR between \$1.25 and \$1.50 per square foot per month, or \$15,000 to \$18,000 per year. The contract thus provides a subsidy of about \$15,000 per annum for the rental of GBR's office space.

Under the provisions of the contract, rental fees for use of Cal Expo are determined by a sliding scale based on the average daily handle. (See Table 10 below.)



TABLE 10  
GOLDEN BEAR RACEWAY RENTAL PAYMENT SCALE

<u>Average Daily Handle</u>	<u>Rent Per Day</u>
\$0 to \$300,000	\$0
\$300,000 to \$350,000	\$500
\$350,000 to \$400,000	\$1,000
\$400,000 to \$450,000	\$1,500
\$450,000 to Infinity	\$2,000

Table 11 shows the rental fees paid by GBR to the state in the 1979-80 and the 1980-81 fiscal years.

TABLE 11  
GOLDEN BEAR RENTAL FEES

	<u>1979-80 Fiscal Year</u>	<u>1980-81 Fiscal Year</u>
Rent	\$31,500	\$38,284
Credit <sup>1/</sup>	<u>12,242</u>	<u>9,525</u>
Amount Paid	<u>\$19,258</u>	<u>\$28,759</u>

<sup>1/</sup> Golden Bear's actual rents are reduced by the amount of rent paid by the Orange Julius concessionaire. Total rent for 1979-80 was \$31,500, 1980-81 rent was \$38,284. These amounts were reduced by concessionaire rent of \$12,342 in 1979-80 and \$9,525 in 1980-81.

These rents, in comparison to those paid at other racing facilities, are extremely low. For example, Southern California Racing Association (SCRA), another Lloyd Arnold enterprise, pays a rental fee for use of Los Alamitos Raceway equal to 1.03 percent of the meet's total wagering handle. If GBR rent was equal to the rents paid by SCRA, it would have incurred additional rents of \$176,047 in 1979-80 and \$121,863 in 1980-81. (See Table 12.)

TABLE 12

COMPARISON OF RENTS PAID BY SOUTHERN CALIFORNIA RACING ASSOCIATION  
AND  
GOLDEN BEAR RACEWAY<sup>1/</sup>  
1979-80 and 1980-81 Fiscal Years

	<u>1979-80</u>	<u>1980-81</u>
Golden Bear Raceway <sup>2/</sup>	\$19,258	\$28,759 <sup>3/</sup>
Golden Bear Rents if Paid at SCRA rates <sup>4/</sup>	<u>\$195,305</u>	<u>\$150,622</u>
Savings to Golden Bear Raceway	\$170,047	\$121,863

<sup>1/</sup> SCRA leases Los Alamitos Race Course & Golden Bear leases Cal Expo.

<sup>2/</sup> See footnote 1, Table 11.

<sup>3/</sup> The 1980-81 meet ran 39 days - 24 days less than the 69-day 1979-80 meet. The average day handle was higher and thus generated greater rental receipts

<sup>4/</sup> SCRA pays a flat 1.03 percent of total handle.

According to proponents of the contract, the reduced rental fee provides a margin of profit that enables GBR to continue racing in Sacramento. Proponents further state that this meet generated state racing revenues of \$123,715 in 1979-80 and \$235,054 in 1980-81. As Table 13 illustrates, the meet also generated gross revenues to GBR of \$818,766 in 1980 and \$627,826 in 1981.

TABLE 13

GOLDEN BEAR RACEWAY  
SELECTED ITEMS OF REVENUE<sup>1/</sup>  
1980 and 1981

	<u>1980</u>	<u>1981</u>
Admissions	\$348,750	\$270,872
Program Sales	145,498	105,519
Parking	125,761	96,177
Concession Commissions	176,748	139,630
Program Advertising	<u>22,009</u>	<u>15,628</u>
	\$818,766	\$627,826

<sup>1/</sup> Note: Data taken from 1980 and 1981 Golden Bear Raceway Financial Statements (Racing Years).

Although Golden Bear Raceway received \$316,378 in concession commissions during this period, contract terms do not provide for the State of California to receive any payment for concessions during the harness racing meets.

We were unable, in our review of Golden Bear Raceway's annual financial statements, to determine the Association's actual financial condition. (The statements' formats were not consistent with statements of other racing associations and did not include concession revenues.) Consequently, we cannot verify the proponents' claim.

Based on the provisions discussed above, we conclude that these contracts are heavily weighted in favor of the lessee. It should be noted that the Golden Bear Raceway agreement was not successfully negotiated by the staff at Cal Expo but as a result of impasse was negotiated instead--at the order of the Governor's Chief of Staff--by the Deputy Director of the Department of Finance.

We recommend that the state's interest should be asserted in future renegotiations of the Food Service and Golden Bear Raceway contracts. Such negotiations should be conducted by the management of Cal Expo with the participation of a representative of the State Controller's Office.



## APPENDICES



## COMPARISON OF THE 1980 AND 1981 CALENDAR YEAR RACING ACTIVITY

The following Tables compare 1980 calendar year Horse Racing Revenues (pre AB 3383) with 1981 calendar year Horse Racing Revenues (post AB 3383).

Table A shows the total amount wagered in calendar years 1981 and 1982 and distributed between the wagering public, the State, the Racing Associations, and the Horsemen. The Table also compares the two calendar years showing the dollar growth and the percentage growth from 1980 to 1981. (1981 figures are provided by the California Horse Racing Board and are unaudited.) Table B presents 1981 estimated wagering activity without AB 3383 and assuming an average growth in total wagering activity. Table C estimates 1981 revenues without the passage of AB 3383. These estimates are based upon: (1) the actual 1981 handle (total amount wagered), and (2) an allocation of that handle based upon the actual percentage each participant received in 1980. Table D compares 1980 and 1981 wagering per attendee. Table E presents 1980 and 1981 wagering activity per racing day. Table F illustrates selected horse racing data for calendar years 1971 through 1981. Table G shows a comparison of racing dates by associations for 1980 and 1981.

Analysis of the data indicates the following:

- The 1981 Total Handle (amount wagered) was 12.69 percent greater than in 1980 (Table A). The average annual growth in Handle from 1971 to 1981 is 8.55 percent. The average annual growth over the same period, excluding 1981, is 8.09 percent (Table F). Thus, the 1981 growth rate exceeded the 9-year and 10-year averages by 4.59 percent and by 4.41 percent, respectively. Although we are unable to determine the exact cause of this growth, we can safely assume it is a product of the increase from 1002 to 1093 in the number of racing days (Table F), the emergence of Pick-Six wagering and a 6.72 percent growth in attendance (Table F). While we are unable to determine the exact impact of the three factors, it is interesting to note that during the passage of AB 3383, the racing industry estimated that Pick-Six wagering by itself would increase the total Handle by 10 percent.
- There was a decrease of .15 percent (approximately \$3.2 million) in the total amount Returned to the Public with a corresponding .15 percent increase in the Take Out. This is significant since Temple, Barker, and Sloan recommended that the total Take Out be reduced not increased.
- State Revenue in 1981 was \$14.3 million or 10.68 percent less than State Revenue in 1980 (Table A). The term state revenue represents the state's share of the Take Out and does not include revenue the state receives from fines and penalties, unclaimed pari-mutuel winnings and occupational license fees.
- Racing associations received \$27.4 million or 26.25 percent more in 1981 than in 1980.
- Horsemen's 1981 Revenue was \$31.8 million or 35.10 percent greater than 1980 revenues.

- Since 1971 (excluding 1981) State Revenues have experienced an annual average growth of 8.29 percent. During the same period, Racing Associations and Horsemen's revenues grew at an average annual rate of 10.93 percent and 12.18 percent, respectively (Table F).
- Average race day attendance in 1981 was 11,661 persons, down from the 1980 average of 11,853 persons.

The above revenue figures actually understate the impact of AB 3383 on State Racing Revenues and overstate its impact on Revenues to the Associations and Horsemen. If AB 3383 had not been enacted, based on historical activity (Table F), it is safe to assume that 1981 wagering activity would still have been greater than the amount wagered in 1980. Assuming an average growth in total wagering activity (8.09 percent - Table F), we estimate 1981 State Revenues would have been approximately \$145 million - about \$25.1 million more than actual 1981 State Revenues (Table B). Based upon the same assumptions, 1981 estimated Revenues to Racing Associations and Horsemen would have been \$112.8 million (\$19 million less than actual 1981 Revenues) and \$97.9 million (\$24.5 million less than 1981 actuals), respectively (Table B).

Table C presents an additional scenario estimating the magnitude of the 1981 State Horse Racing Revenue loss. This table assumes that AB 3383, by itself, had no impact on the 1981's wagering activity. It assumes, instead, that the 12.69 percent increase in the 1981 total handle was a result of Pick-Six betting and normal inflationary growth. The allocation of the total handle was based on 1980's actual percentage distribution. Under this scenario the public would have received an additional \$3.2 million, the state's share would have increased by \$31.3 million to \$150.9 million. The 1981 Associations revenues would have decreased by \$14.1 million to \$117.7 million while Horsemen would have received \$20.3 less or \$102.1 million. It is interesting to note that under this distribution, 1981 State Revenues would have grown by 12.70 percent over the 1980 level. In addition, 1981 revenues to Racing Associations would have experienced a 12.74 percent increase while Horsemen's 1981 revenues would have increased by 12.69 percent.

While the actual 1981 State Horse Racing Revenue loss will never be known, it can safely be assumed to be somewhere between the maximum loss shown on Table C (\$31.3 million) and the minimum amount shown on Table B (\$14.3 million).



TABLE A

DISTRIBUTION OF 1980 and 1981 CALENDAR YEAR  
HORSE RACING REVENUES  
(Dollars in Millions)

<u>Year</u>	<u>Total Amount Wagered</u>	<u>Returned to Public</u>	<u>Take Out</u>	<u>State Revenue<sup>1/</sup></u>	<u>Revenue to Associations</u>	<u>Revenue to Horsemen</u>
1980	\$1,822	\$1,493.1	\$328.9	\$133.9	\$104.4	\$90.6
% of Total Amount Wagered	--	81.95%	18.05%	7.35%	5.73%	4.97%
% of Take Out	--	--	--	40.71%	31.74%	27.55%
1981	\$2,053.3	\$1,679.6	\$373.8	\$119.6	\$131.8	\$122.4
% of Total Amount Wagered	--	81.80%	18.20%	5.83%	6.42%	5.96%
% of Take Out	--	--	--	32.00%	35.27%	32.75%
± Growth 1980 to 1981	+ \$231.3	+ \$186.4	+ \$44.9	- \$14.3	+ \$27.4	+ \$31.8
% Growth 1980 to 1981	+ 12.69%	+ 12.48%	+ 13.62%	- 10.68%	+ 26.25%	+ 35.10%

<sup>1/</sup> The State's share of the Take Out does not include unclaimed winning tickets.  
See footnote to Figure 1, page 9, for this detail.

TABLE B

ESTIMATED 1981 HORSE RACING REVENUES ASSUMING AN AVERAGE<sup>2/</sup> GROWTH IN TOTAL WAGERING  
(Dollars in Millions)

	<u>Total Amount Wagered</u>	<u>State Revenue<sup>1/</sup></u>	<u>Revenue to Associations</u>	<u>Revenue to Horsemen</u>
1981 Estimates	\$1969.4	\$144.8	\$112.8	\$97.9
1980 Actuals	\$1822.0	\$133.9	\$104.4	\$90.6
1981 Actuals	\$2053.3	\$119.6	\$131.8	\$122.4
Difference Between 1981 Estimates and 1980 Actual	+ \$147.4	+ \$11.1	+ \$8.4	+ \$7.3
Percent Growth 1980 Actuals to 1981 Estimates	+ 8.09%	+ 8.29%	+ 8.05%	+ 8.06%
Difference Between 1981 Actuals and 1981 Estimates	+ \$83.9	- \$25.1	+ \$19.0	+ \$24.5

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<sup>1/</sup> See Table A, Footnote 1

<sup>2/</sup> The average annual growth between 1971 and 1980 was used to expand 1980 activity for the 1981 estimates.

TABLE C

DIVISION OF 1981 WAGERING ACTIVITY ALLOCATED BASED UPON 1980 DISTRIBUTION RATIOS  
(Dollars in Millions)

	<u>Total Amount Wagered</u>	<u>Returned to Public</u>	<u>Take Out</u>	<u>State Revenue</u>	<u>Revenue to Associations</u>	<u>Revenue to Horsemen</u>
1981 Estimated Distribution <sup>1/</sup>	\$2,053.3	\$1,682.7	\$370.6	\$150.9	\$117.7	\$102.1
Actual 1981 Distribution	\$2,053.3	\$1,679.6	\$373.7	\$119.6	\$131.8	\$122.4
Actual 1980 Distribution	\$1,822.0	\$1,493.1	\$328.9	\$133.9	\$104.4	\$ 90.6
Difference between 1981 Actual and 1981 at 1980 ratios	--	+ \$3.2	- \$3.2	+ \$31.3	- \$14.1	- \$20.3
Difference between 1981 at 1980 ratios and 1980 actuals	--	+ \$189.6	+ \$41.7	+ \$17	+ \$13.3	+ \$11.5
% Growth $\pm$ between 1981 at 1980 ratios and 1980 actuals	--	+ 12.70%	+ 12.68%	+ 12.70%	+ 12.74%	+ 12.69%

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<sup>1/</sup> The dispersal of the total handle is based on 1980 ratios.

TABLE D  
COMPARISON OF PER CAPITA HORSE RACING REVENUES 1980 to 1981  
(Dollars in Millions)

	<u>Per Capita Total Wagered</u>	<u>Per Capita Returned to Public</u>	<u>Per Capita Take Out</u>	<u>Per Capita State Share</u>	<u>Per Capita Revenue to Associations</u>	<u>Per Capita Revenue to Horsemen</u>
1980	\$153.11	\$125.47	\$27.64	\$11.25	\$ 8.85	\$7.61
1981	\$161.68	\$132.24	\$29.43	\$ 9.42	\$10.38	\$9.64

TABLE E  
WAGERING ACTIVITY PER RACING DAY 1980 and 1981

	<u>Total Wagered Per Racing Day</u>	<u>Returned To Public</u>	<u>Take Out</u>	<u>State Share</u>	<u>To Associations</u>	<u>To Horsemen</u>
1980	\$1,818,363	\$1,490,120	\$328,244	\$133,633	\$104,192	\$ 90,419
1981	\$1,878,591	\$1,536,597	\$341,995	\$109,424	\$120,586	\$111,985

TABLE F

ANNUAL COMPARISON OF SELECTED HORSE RACING DATA 1971-1981  
(Attendance and Dollars in Millions)

	1971	1972	1973	1974	1975	1976 <sup>1/</sup>	1977	1978 <sup>2/</sup>	1979	1980	1981	Average Annual Growth 1971-1980
Attendance	9.3	9.2	9.8	9.9	10.7	10.5	10.8	10.5	10.4	11.9	12.7	
% Annual Change		-1.07	+8.52	+1.02	+8.08	-1.87	+2.86	-2.78	-.95	+14.42	+6.72	+2.91%
Total Handle	903.1	950.3	1033.5	1112.4	1245.9	1305.1	1465.9	1516.3	1563.6	1822.0	2053.3	
% Annual Change		+5.23	+8.76	+7.63	+12.00	+4.75	+12.32	+3.44	+3.12	+16.53	+12.69	+8.09%
Returned to Public	755.5	790.4	860.1	926.3	1037.7	1086.9	1218.6	1242.6	1281.2	1493.1	1679.5	
% Annual Change		+9.32	+8.82	+7.70	+12.03	+4.74	+12.12	+1.97	+3.12	+16.54	+12.48	+8.48%
Take Out	147.5	159.9	173.4	186.2	208.2	218.2	247.3	273.7	282.4	328.9	373.8	
% Annual Change		+8.33	+8.44	+7.38	+11.82	+4.80	+13.34	+10.68	+3.18	+16.47	+13.65	+9.38%
State Revenue	65.9	68.7	74.2	79.9	90.1	95.2	107.5	110.7	114.4	133.9	119.6	
% Annual Change		+14.25	+8.00	+7.68	+12.77	+5.66	+12.92	+2.98	+3.34	+17.05	-10.68	+8.29%
Revenue to Associations	48.7	54.3	59.1	63.7	69.9	71.8	84.1	87.4	90.2	104.4	131.8	
% Annual Change		+11.50	+8.84	+7.78	+9.73	+2.72	+17.13	+21.73	+3.20	+15.74	+26.25	+10.93%
Revenue to Horsemen	33.1	37.0	40.2	42.7	48.2	51.2	55.7	75.6	77.8	90.6	122.4	
% Annual Change		+11.78	+8.65	+6.22	+12.88	+6.22	+8.79	+35.73	+2.91	+16.45	+35.10	+12.18%
Number of Racing Days	773	829	885	897	906	893 <sup>3/</sup>	947	996	950	1002	1093	

1/ Began to be designated as Paid Attendance.

2/ Began to be designated as Reported Attendance.

3/ 42 days lost due to labor strike.

TABLE G  
COMPARISON OF RACING DATES  
1980 to 1981

	1980					1981					Difference in Days 1980 to 1981
	Racing Dates		Number of Weeks	Number of Days	Days per Week	Racing Dates		Number of Weeks	Number of Days	Days per Week	
Thoroughbred Races											
Los Angeles Turf Club.....	12/26/79	4/7/80	15	77	5	12/26/80	4/22/81	17	86	5	+ 9
Santa Anita, Arcadia											
Pacific Racing Association.....	2/7/80	4/29/80	11	58	5	2/3/81	5/8/81	13	69	5	+ 11
Golden Gate Fields, Albany											
Hollywood Turf Club.....	4/9/80	7/21/80	15	77	5	4/21/81	7/20/81				
Hollywood Park, Inglewood						11/11/81	12/23/81	19	97	5	+ 20
Tanforan Racing Association.....	4/30/80	6/7/80	5	29	5	5/9/81	6/27/81	7	36	5	+ 7
Golden Gate Fields, Albany											
Del Mar Thoroughbred Club.....	7/23/80	9/10/80	7	43	6	7/22/81	9/9/81	7	43	6	0
Del Mar											
Tanforan Racing Association.....	9/1/80	10/11/80	6	30	5	9/22/81	10/17/81	4	20	5	- 10
Bay Meadows, San Mateo											
Oak Tree Racing Association.....	10/17/80	11/17/80	5	25	5	9/30/81	11/9/81	6	32	5	+ 7
Santa Anita, Arcadia											
Bay Meadows Racing Association.....	10/15/80	1/3/81	11	59	5	1/6/81	1/31/81				
Bay Meadows, San Mateo						10/20/81	12/23/81	13	67	5	+ 8
Totals.....	-	-	75	398	-	-	-	86	450	-	+ 52
Harness Horse Meetings:											
California Horse Racing Assn.....	12/27/79	2/2/80	7	30	6	-	-	-	-	-	
Bay Meadows, San Mateo											
Harness Racing of Del Mar.....	-	-	-	-	-	10/28/81	12/20/81	8	39	5	+ 9
Del Mar											
Southern California Racing Assn.....	2/21/80	4/28/80	9	58	6	2/23/81	5/2/81				
Los Alamitos						6/30/81	8/15/81	16	95	6/5	+ 37
Golden Bear Raceway.....	5/8/80	8/3/80	12	63	5	5/7/81	6/28/81	8	39	5	- 24
Sacramento											
Western Harness Racing Inc.....	8/21/80	12/8/80	15	79	5	1/19/81	2/24/81				
Hollywood Park, Inglewood						8/15/81	10/26/81	15	76	5	- 3
Totals.....	-	-	43	230	-	-	-	47	249	-	+ 19

(continued)

TABLE G (cont'd)

COMPARISON OF RACING DATES  
1980 to 1981

	1980					1981					Difference in Days 1980 to 1981
	Racing Dates		Number of Weeks	Number of Days	Days per Week	Racing Dates		Number of Weeks	Number of Days	Days per Week	
Quarter Horse Meetings:											
Horsemen's Quarter Horse Racing Assn. Los Alamitos	12/7/79	2/12/80	9	58	6	12/6/80 11/10/81	2/11/81 12/23/81	16	96	6	+ 38
Peninsula Horse Racing Assn..... Bay Meadows, San Mateo	2/22/80	5/11/80	11	53	5	2/26/81	5/3/81	10	49	5	- 4
Los Alamitos Race Course..... Los Alamitos	5/16/80	8/19/80	13	82	6	5/11/81	8/21/81	14	95	6	+ 13
Totals.....	-	-	33	193	-	-	-	40	240	-	+ 47
Fair Race Meetings:											
California Mid-Winter, Imperial.....	3/15/80	3/30/80	-	12	6	-	-	-	-	-	- 12
San Bernardino Co., Victorville.....	4/12/80	4/27/80	-	14	6	-	-	-	-	-	- 14
Solano County, Vallejo.....	6/9/80	6/21/80	-	12	6				12	6	0
Alameda County, Pleasanton.....	6/23/80	7/5/80	-	11	6				12	6	+ 1
Sonoma County, Santa Rosa.....	7/7/80	7/19/80	-	12	6				12	6	0
San Mateo County, San Mateo.....	7/21/80	8/2/80	-	12	6				12	6	0
Humboldt County, Ferndale.....	7/24/80	8/2/80	-	9	6				9	6	0
San Joaquin County, Stockton.....	8/4/80	8/16/80	-	12	6				12	6	0
California Exposition, Sacramento....	8/18/80	9/1/80	-	14	6				14	5	0
Fresno District, Fresno.....	9/5/80	9/20/80	-	14	6				14	6	0
Southern Cal Exposition, Del Mar.....	9/12/80	9/25/80	-	12	6				8		- 4
Los Angeles County, Pomona.....	9/27/80	10/12/80	-	14	6				16	6	+ 2
Orange County, Los Alamitos.....	11/19/80	12/1/80	-	12	6				12	6	0
Totals.....	-	-	-	160	-				133		- 27
Mixed Race Meeting											
Calfax Racing Assn, Fresno.....	5/3/80	5/31/80	3	21	5			4	21	5	0
Grand Totals.....	-	-	154	1,002	-			177	1,093	-	+ 91





FINANCIAL RATIO ANALYSISGeneral Comments:

Ratios are among the best known and most widely used tools of financial analysis. At the same time, their function is often misunderstood and consequently their significance may easily be overrated.

A ratio expresses the mathematical relationship between one quantity and another. The ratio of 200 to 100 may be expressed as 2, of 250 to 100 as 2.5 and so on. While the computation of a ratio involves a simple arithmetic operation, its interpretation is a far more complex matter. To be significant, the ratio must express a relationship that has significance.

Properly interpreted, ratios may point out areas requiring further investigation. The analysis of a ratio will often disclose relationships as well as bases of comparison which reveal conditions and trends that cannot be detected by an inspection of the individual components of the ratio.

Specific Ratios:

Liquidity Ratios - The current and debt ratios were reviewed in order to gain some understanding as to the risk of investment in the various associations and as to their sources of financing. These ratios varied tremendously between the various associations as well as by year within each association.

The current ratio which indicates ability to meet short term obligations from liquid assets varied from a low of .05 to a high of 9.62. A current ratio of less than one would indicate that the entity would not be able to meet its current obligations from current assets or that the entity was insolvent in the short run.

The debt ratio is an indication of the source of overall financing for an entity and is computed by dividing total debt by net worth. A debt ratio equal to one indicates that equal amounts of capital come from creditors and stockholders. A ratio less than one indicates that a majority of capital is supplied by creditors, greater than one, that a majority of capital is supplied by stockholders.

The majority of ratios reviewed were substantially less than one although two associations had debt ratios greater than one in all five years reviewed. One association, Golden Bear Raceway, had a deficit larger than its contributed capital. This indicates that its operations are financed completely on credit and it is insolvent.

Profitability Ratios - The operating and net profit ratios are indications of profitability. The operating ratio is computed by dividing total expenses by total revenues and reveals what portion of each dollar of revenue is expensed. The net profit margin is computed by dividing net income by total revenues. It is the complement of the operating ratio.

Again, the associations vary greatly but in this area, the profitability of individual associations is relatively stable from year to year. All associations, with the exception of Golden Bear Raceway, were profitable in all years reviewed. The degree of profitability ranged from a .43% net profit margin to a 15.35% net profit margin.

The high degree of variability between associations in the above ratios preclude any meaningful generalizations about the industry.

Performance Ratios - Return on assets and owners equity are indications of the overall performance of the entity and its efficacy as an investment. Return on total assets, excluding Golden Bear Raceway, ranged from a low of 3% to a high of 30%, the median return on total assets being near 11% for the period reviewed. Return on owners equity ranged from a low of 8.9% to a high of 112%. This appears to be the most significant of the ratios reviewed in relation to the requests of the racing industry. To fully understand the import of these ratios they should be compared to the returns on equity yielded by other industries during this period. Some examples are:

	<u>Banking</u>	<u>Amusement and Leisure Time</u>	<u>Retail Food</u>	<u>Regulated Investment Companies</u>
1977	.057	.060	.089	.050
1978	.029	.026	.086	.045
1979	.088	.039	.079	.045
1980	.088	.058	.077	.052

It is obvious from this comparison that the racing industry is more lucrative than the other industries shown during the period reviewed.

In relation to this ratio, the industry argues that using equity to compute this ratio is misleading and does not reflect the true return as it does not reflect the current market value of the assets held by the owner-associations in the form of land and fixtures.

The industry, however, neglects to mention the fact that the appreciation of such assets insures a higher real return to them. It makes their stock holdings much more valuable should they wish to sell them or liquidate the corporation and sell the land holdings. The fact that the increase in land value is not recognized on the

books of the association under generally accepted accounting principles allows them to defer the related tax effects on the appreciation to some future period and receive preferential tax treatment at that time. Their argument also ignores the fact that the return on equity is computed in the same manner for all other industries in the United States. For the horse racing industry to use other methods, not generally accepted, to account for returns and holdings, would result in misleading financial statements.

COMPARISON OF SELECTED FINANCIAL RATIOS  
MAJOR CALIFORNIA HORSE RACING ASSOCIATIONS  
1977 - 1981

	California Jockey Club	Del Mar Thoroughbred Club	Golden Bear Raceway	Hollywood Park, Inc.	Horseman's Quarter Horse Racing Assoc.	Los Alamitos Race Course	Los Angeles Turf Club	Oak Tree Racing Assoc.	Southern Calif. Racing Assoc.	Tanforan Racing Assoc.
<b>Current Ratio</b>										
1977	1.1960	.9707	.1174	1.3043	2.7497	4.9903	.5265	9.6248	1.8684	N/A
1978	1.2641	1.0460	.0472	1.9868	5.7645	3.8367	.5513	9.5999	2.8524	1.8894
1979	1.9101	1.1420	.1400	1.4304	1.9861	4.0566	1.1881	8.4330	2.7908	3.1455
1980	1.3930	1.2608	1.0340	1.3472	3.2555	2.6306	.9252	8.1863	3.4428	2.2116
1981	N/A	1.2378	1.1059	1.0818	9.3910	1.9577	N/A	3.9594	1.4090	N/A
<b>Debt Ratio</b>										
1977	.5564	4.3020	<u>-2/</u>	.5452	.2230	.1521	3.2837	.1159	.4521	N/A
1978	.6210	2.4416	<u>-2/</u>	.6233	.1228	.1187	1.2079	.1163	.2773	.3466
1979	.1716	1.9417	<u>-2/</u>	.5839	.2303	.1083	1.4954	.1345	.3191	5.5569
1980	.3325	2.7179	<u>-2/</u>	.6737	.1443	.1943	3.9246	.1391	.2331	2.3258
1981	N/A	2.3890	<u>-2/</u>	.5877	.0645	.1634	N/A	.3349	1.2816	N/A
<b>Operating Ratio</b>										
1977	.9348	.9957	1.1530	.9067	.9318	.8495	.9681	.9867	.9590	.9534
1978	.9219	.9840	- .9742	.8884	.9314	.8696 <sup>4/</sup>	.9648	.9644	.9445	.9351
1979	.9198	.9851	1.3207	.8863	.9533	.8890	.9773	.9826	.9617	.9816
1980	.9260 <sup>1/</sup>	.9822	-1.0141	.8834	.9342	.9097	.9794	.9764	1.0194 <sup>5/</sup>	.9299
1981	N/A	.9667	.9917	.8750	.8888	.8465	N/A	.9720	.9763	N/A
<b>Net Profit Margin</b>										
1977	.0652	.0043	- .1530	.0933	.0682	.1505	.0319	.0133	.0409	.0466
1978	.0781	.0160	.0258	.1116	.0686	.1304 <sup>4/</sup>	.0352	.0356	.0555	.0649
1979	.8020	.0149	- .3207	.1137	.0467	.1110	.0227	.0174	.0383	.0184
1980	.0740 <sup>1/</sup>	.0178	- .0141	.1117	.0658	.0903	.0206	.0236	- .0194 <sup>5/</sup>	.0701
1981	N/A	.0333	.0083	.1250	.1112	.1535	N/A	.0280	.0237	N/A
<b>Return on Total Assets</b>										
1977	.1379	.0320	- .9146	.0874	.2157	.1064	.2623	.0881	.1152	N/A
1978	.1581	.1227	.2852	.0946	.1960	.0941 <sup>4/</sup>	.2641	.2064	.1565	.2952
1979	.2260	.1067	1.7772	.1108	.1090	.0800	.1274	.0960	.0935	.0762
1980	.1826 <sup>1/</sup>	.0426	- .1214	.1066	.1589	.0909	.0652	.1277	- .0639 <sup>5/</sup>	.2147
1981	N/A	.0743	.0935	.1437	.2567	.1351	N/A	.1304	.0525	N/A

COMPARISON OF SELECTED FINANCIAL RATIOS  
MAJOR CALIFORNIA HORSE RACING ASSOCIATIONS  
1977 - 1981

	California Jockey Club	Del Mar Thoroughbred Club	Golden Bear Raceway	Hollywood Park, Inc.	Horseman's Quarter Horse Racing Assoc.	Los Alamitos Race Course	Los Angeles Turf Club	Oak Tree Racing Assoc.	Southern Calif. Racing Assoc.	Tanforan Racing Assoc.
Return on Owners' Equity										
1977	.2146	.1698	<u>-2/</u>	.1350	.2638	.1226 <sup>4/</sup>	1.1234	.0983	.1673	N/A
1978	.2563	.4222	<u>-2/3/</u>	.1536	.2201	.1053 <sup>4/</sup>	.5832	.2304	.2000	.3975
1979	.2648	.3139	<u>-2/</u>	.1536	.1341	.0886	.3192	.1089	.1234 <sup>5/</sup>	.4999
1980	.2653 <sup>1/</sup>	.1583	<u>-2/</u>	.1784	.1818	.1085	.3203	.1454	-.0792 <sup>5/</sup>	.7141
1981	N/A	.2519	<u>-2/3/</u>	.2126	.2724	.1572	N/A	.1741	.1198	N/A

- 1/ Charity expenses are intermingled with the tracks' other expenses, thus, charity proceeds are included as an expense. Consequently, the operating ratio is understated.
- 2/ Because total stockholders' equity is a negative number the calculations of the noted ratios would not be meaningful.
- 3/ Golden Bear showed a profit in 1978 of \$46,935 and in 1981 of \$21,335. In effect, these profits were made on borrowed money. While this company does not seem to make any money it should be noted this company is owned entirely by the Arnold family and preliminary investigation indicated the Arnolds are paid some type of salary by the company.
- 4/ Note to summary of Revenue and Expenses in 1978 financial report states that subsequent to the preparation of the statement an error was discovered. Track pari-mutuel was understated by \$7,040.99 and charity revenues was overstated by \$7,040.99.
- 5/ The net loss included an extraordinary expense item of \$175,000. Net income before this item was \$87,273. This expense involved the transfer of ownership of SCRA to Arnold. Without this expense the operation ratio was .9807, the net profit margin was .0193, the return on total assets was .0639, and the return on owners equity was .0788.



CALIFORNIA LEGISLATURE

**ANALYSIS OF THE BUDGET BILL**

*of the*

**STATE OF CALIFORNIA**

*for the*

**Fiscal Year July 1, 1982, to June 30, 1983**

**Report of the Legislative Analyst**

*to the*

**Joint Legislative Budget Committee**

**HON. DAVID A. ROBERTI**  
*President pro Tempore  
of the Senate*

**HON. WILLIE L. BROWN, JR.**  
*Speaker of the Assembly*

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Maxine Waters

**WILLIAM G. HAMM**  
*Legislative Analyst*

**CALIFORNIA HORSE RACING BOARD**

Item 8550 from the Fair and Ex-  
position Fund and various  
funds

Budget p. GC 86

Requested 1982-83 .....	\$4,392,000
Estimated 1981-82 .....	4,053,000
Actual 1980-81 .....	2,973,000
Requested increase (excluding amount for salary increases) \$339,000 (+ 8.4 percent)	
Total recommended reduction .....	\$25,000

**1982-83 FUNDING BY ITEM AND SOURCE**

Item	Description	Fund	Amount
8550-001-191—Horse Racing Board		Fair and Exposition	\$1,339,000
8550-001-942—Horse Racing Board		Special Deposit	53,000
—Continuing Appropriation—Horse- man's Organization Welfare Special Account		Special Deposit	1,300,000
—Continuing Appropriation—Stand- ardbred Sires Stakes Fund Account		Special Deposit	1,700,000
Total			\$4,392,000

**SUMMARY OF MAJOR ISSUES AND RECOMMENDATIONS**Analysis  
page

1. *Salary Savings. Reduce Item by \$25,000.* Recommend an increase in salary savings to reflect prior years' experience. 1688
2. *Fiscal Management.* Recommend that the Legislature direct the Horse Racing Board to adopt procedures to improve its fiscal management. Further recommend that the Department of Finance report on actions it has taken to enforce the provisions of the Government Code and Executive Order D80-71. 1689

**GENERAL PROGRAM STATEMENT**

The California Horse Racing Board (CHRB) regulates all horse race meetings in the state where pari-mutuel wagering is allowed. Responsibilities of the board include the promotion of horse racing, regulation of wagering, and maximizing the horse racing revenues collected by the state. The board's activities consist of (1) licensing all participants in horse racing, (2) contracting with stewards to officiate at all races, (3) enforcing the regulations and laws under which racing is conducted, and (4) collecting the state's horse racing revenues. The board consists of seven members appointed by the Governor, and has a staff of 49.4 authorized positions in the current year.

**ANALYSIS AND RECOMMENDATIONS**

The budget proposes total program expenditures of \$5,462,000 from various funds to support the California Horse Racing Board in 1982-83. This is a \$409,000, or 8.1 percent, increase over estimated current-year expenditures. This amount will increase by the amount of any salary or



**CALIFORNIA HORSE RACING BOARD—Continued**

staff benefit increase approved for the budget year.

Expenditures proposed for the budget year will be funded by \$1,339,000 from the Fair and Exposition Fund (a 3.6 percent increase over the current year), \$53,000 from the Racetrack Security Account, \$1,070,000 in reimbursements for steward's expenses, a \$1,700,000 statutory appropriation for the Standardbred Sires Stakes program, and \$1,300,000 appropriated by statute for the Horseman's Organization Welfare Special Account. Table 1 shows personnel-years and expenditures, by program, for the prior, current, and budget years.

**Table 1**  
**California Horse Racing Board**  
**Summary of Program Expenditures**  
(thousands)

Program	Personnel-years			Expenditures		
	Actual 1980-81	Estimated 1981-82	Requested 1982-83	Actual 1980-81	Estimated 1981-82	Requested 1982-83
Licensing .....	10.0	11.0	11.0	\$245	\$257	\$266
Enforcement .....	12.8	14.0	14.0	613	696	719
State Steward .....	13.0	14.0	14.0	884	1,000	1,070
Standardbred Sires Stakes .....	0.7	1.0	1.0	1,486	1,600	1,700
Administration .....	8.5	9.4	9.4	368	385	407
Horseman's Organization Welfare Special Ac- count .....	—	—	—	261	1,115	1,300
Subtotals .....	45.0	49.4	49.4	\$3,857	\$5,053	\$5,462
<i>Financing</i>						
California Standardbred Sires Stakes Fund Ac- count .....	—	—	—	\$1,486	\$1,600	\$1,700
Fair and Exposition Fund .....	—	—	—	1,226	1,285	1,339
Racetrack Security Ac- count .....	—	—	—	—	53	53
Horseman's Organization Welfare Special Ac- count .....	—	—	—	261	1,115	1,300
Reimbursements .....	—	—	—	\$884	\$1,000	\$1,070

**Salary Savings Underbudgeted**

*We recommend that additional salary savings be reflected in the board's budget in line with recent experience, for a reduction of \$25,000.*

When budgeting for salaries and wages, agencies normally recognize that salary levels will fluctuate, and that all positions will not be filled for a full 12 months. Experience shows that savings will accrue due to the following factors: vacant positions, leaves of absence, delays in filling new positions, and the filling of positions at the minimum step of the salary range. Therefore, to prevent overbudgeting, an estimate of salary savings is included in each budget.

Actual experience has shown that the board realizes some salary savings each year. Its budget requests, however, have consistently failed to provide for such savings. For example, the board finished 1978-79 and 1979-80 with unexpended balances in its personnel service account of approximately \$36,000 and \$34,000, respectively. In 1980-81, the Legislature re-

duced the board's budget request by \$20,000 to reflect anticipated salary savings, but the board was still able to generate \$15,000 in salary savings, which it then expended on operating expenses and equipment. In 1981-82, the Legislature reduced the board's request by \$30,000 to account for salary savings.

The proposed budget anticipates salary savings of only \$10,000. Based on actual salary savings achieved in the past, we recommend the budget be reduced by \$25,000 to reflect the additional salary savings that is likely to occur, for a corresponding savings to the General Fund.

**Board's Report on Horseman's Organization Welfare Special Account is Inadequate**

Chapter 1043, Statutes of 1980, which became effective on January 1, 1981, established two new programs to be financed from unclaimed pari-mutuel winnings. Previously, unclaimed winnings were deposited in the General Fund. Fifty percent of the unclaimed parimutuel winnings are to be made available to the CHRB, subject to budgetary review by the Legislature, and 50 percent is allocated to various horseman's organizations to finance the provision of health care and welfare benefits to employees of horse owners and trainers.

*The Supplemental Report of the 1981 Budget Act* directed the Horse Racing Board, on or before January 1, 1982, to prepare a report on the use of these unclaimed pari-mutuel winnings by the Horseman's welfare organizations. The report was to include, but not be limited to: (a) a description of each activity or program funded from this source, (b) regulations and rules adopted by the board governing these activities and programs, (c) a five-year estimate of the annual total cost of programs or activities implemented or proposed at the time the report is submitted, and (d) the statutory basis for the programs or activities.

In response to this requirement, the CHRB issued a report in December listing the activities which had been funded up to that time.

We do not believe the board's report is responsive to the Legislature's request. It provides no description of activities funded from the account, and it provides no indication of how the funds will be expended in future years. Further, the report indicates that the board has adopted no rules or regulations governing the activities or programs funded. In sum, the report does not provide the Legislature with sufficient information to evaluate program activity to date.

**Poor Fiscal Management**

*We recommend that supplemental report language be adopted directing the California Horse Racing Board to adopt procedures to improve fiscal management and accountability. We further recommend that the Legislature direct the Department of Finance to report on actions it has taken to enforce the provisions of the Government Code and Executive Order D80-71.*

During 1980-81, the California Horse Racing Board received billings totaling \$82,764 from the Attorney General (AG) for various legal services rendered. The CHRB's 1980-81 budget included \$42,500 for these fees. In June 1981, the board requested and the Department of Finance approved a transfer of \$10,000 from the board's Personnel Service Account to its Operating Expenses and Equipment Account for payment of AG fees. In addition, Executive Order No. D80-71 provided an emergency augmentation of \$37,600 for payment of these AG fees. In total, the Horse Racing

**CALIFORNIA HORSE RACING BOARD—Continued**

Board in 1980-81 received \$90,100 for payment of Attorney General fees. This exceeded the amount of the total billing by \$7,336.

As of January 1, 1982, the board still owed the Attorney General \$29,421 for legal services rendered during 1980-81. According to the board, this bill was not paid because of unexpected increases in other Operating Expenses and Equipment. These expenses, according to the board, had a higher priority for payment than the Attorney General's services.

Our analysis indicates that only \$9,382 of the emergency augmentation provided by executive order was actually expended for payment of Attorney General services, and that the payment was not made until November 1, 1981. The remaining \$28,218 was expended for other operating expenses and equipment.

The Government Code states that "every person who incurs any expenditure in excess of the allotments or other provisions of the fiscal year budget as approved by the department, is liable both personally and on his official bond for the amount of the excess expenditure."

Executive order D80-71 authorized the board to expend the \$37,600 emergency augmentation only for payment of 1980-81 attorney general fees. In fact, the Department of Finance indicates that the board's executive officers were informed that they would be held personally liable if the funds were used for any other purposes.

We believe the Legislature may wish to request an explanation of the board's actions with regard to this matter during hearings on the 1982-83. In any event, to assure that misdirections of appropriated funds do not occur in the future, we recommend adoption of the following supplemental report language:

"The California Horse Racing Board shall adopt procedures to improve its fiscal management, and the Department of Finance shall report to the fiscal committees by December 1, 1982 on actions it has taken to enforce the provisions of the Government Code and its executive order."



**DEPARTMENT OF FINANCE**  
SACRAMENTO

June 1, 1982

Honorable John Holmdahl, Chairperson  
Senate Finance Subcommittee No. 5  
State Capitol, Room 5009  
Sacramento, CA 95814

**DEPARTMENT OF FINANCE FISCAL REVIEW OF THE CALIFORNIA HORSE RACING BOARD**

The Department of Finance has completed its fiscal management review of the California Horse Racing Board (CHRB) requested by Senate Finance Subcommittee No. 5 on March 29, 1982.

The findings and recommendations of the Financial and Performance Accountability Unit are attached. Since the CHRB has just received a copy of the findings, they have not had time to respond.

We recommend the CHRB implement the recommendations outlined in this report both to ensure that the CHRB conform to accepted State accounting practices and to ensure they follow the most cost-effective means of transacting State business.

In addition, the Department of Finance makes the following recommendations regarding specific issues identified in your request:

1. "Rectify improprieties which have occurred in past fiscal years, including legal actions where appropriate."

The fiscal review confirmed the Legislative Analyst's finding that the CHRB did not use monies given to them under Executive Order #D80-71 for the intended purpose. The 1980-81 appropriation was overexpended. In addition, the accrual of accounts payable as of June 30, 1981 was understated on the year-end financial statements.

With respect to the possibility that employees of the CHRB may be held personally liable for any unauthorized expenditure (per Government Code Section 13324), we suggest that this audit be referred to the Attorney General for recommendations as to any potential legal action.

Further, we have informed the CHRB that they are responsible for securing a Deficiency bill to pay outstanding 1980-81 bills.

2. "Ensure that the Board's fiscal affairs are conducted in a responsible fashion in future years."

June 1, 1982

To forestall reoccurrence of fiscal problems, the Department of Finance will take the following steps regarding the CHRB budget:

1. Recommend the Department of General Services, Office of Procurement, review the purchase delegation authority extended the CHRB.
2. Oversee the development of realistic budget allotments and monthly plans of expenditures for the 1982-83 fiscal year, based upon Budget Act appropriations.
3. Review monthly CHRB expenditures versus their monthly plans of expenditures.
4. Require Department of Finance (DOF) approval of all transfers of budget allotments.
5. Require review of all budget documents prior to formal submission to DOF.
6. Work with the CHRB in the planning of their 1983-84 budget needs.
7. Review procedures implemented by the CHRB in response to these recommendations in November, 1982.

We fully expect that implementation of the above measures will help to ensure better management of the CHRB's fiscal affairs.

Please refer any questions to Carl Rogers, Program Budget Manager at (916) 322-2263, leased line 492-2263.

MARY ANN GRAVES  
Director of Finance

Attachments

2619B

cc: Honorable Alfred E. Alquist, Member, Senate Finance Subcommittee No. 5  
Honorable Robert G. Beverly, Member, Senate Finance Subcommittee No. 5  
Honorable Maxine Waters, Chairperson, Assembly Ways & Means Subcommittee No. 4  
Honorable Richard Robinson, Member, Assembly Ways & Means Subcommittee No. 4  
Honorable William Baker, Member, Assembly Ways & Means Subcommittee No. 4  
Honorable David G. Kelley, Member, Assembly Ways & Means Subcommittee No. 4  
Honorable Jim Cramer, Member, Assembly Ways & Means Subcommittee No. 4  
William G. Hamm, Legislative Analyst  
Nathaniel S. Colley, Chairperson, California Horse Racing Board (CHRB)  
Barbara Brooks, Member, CHRB  
Charles Chatfield, Member, CHRB  
Pat Mancini, Member, CHRB  
Lou Cusanovich, Member, CHRB  
Douglas McAvoy, Member, CHRB  
Richard Groulx, Member, CHRB  
Leonard Foote, Executive Secretary, CHRB  
Thomas Hayes, Auditor General

CALIFORNIA HORSE RACING BOARD  
REVIEW OF THE SYSTEM OF  
INTERNAL ACCOUNTING CONTROL  
AND FISCAL PROCEDURES

855-001  
MAY 1982

FINANCIAL AND PERFORMANCE ACCOUNTABILITY  
DEPARTMENT OF FINANCE  
STATE OF CALIFORNIA

**DEPARTMENT OF FINANCE**  
SACRAMENTO

Leonard Foote, Secretary  
California Horse Racing Board  
1010 Hurley Way, Suite 101  
Sacramento, CA 95825

We have made a study and evaluation of the system of internal accounting control and fiscal procedures of the California Horse Racing Board (CHRB) in effect as of May 10, 1982. Our study and evaluation was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

The management of CHRB is responsible for establishing and maintaining a system of internal accounting control and fiscal procedures.

The broad objectives of control systems for state agencies are to provide management with reasonable but not absolute assurance that:

- . Assets are safeguarded from unauthorized use or disposition.
- . Financial records are reliable to permit the preparation of financial statements.
- . Other fiscal procedures ensure the reliability of integrity and information.
- . Control systems enable compliance with policies, plans, procedures, laws and regulations, including the State Administrative Manual.

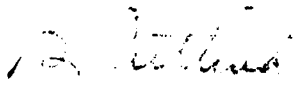
Because of inherent limitations in control systems, errors or irregularities may occur and not be detected. In addition, projection of any evaluation of systems to future periods is subject to risk since procedures may become inadequate because of changes in conditions, or the degree of compliance with procedures may deteriorate.

Our review disclosed major deficiencies in CHRB's system of internal accounting control and fiscal procedures. Several of the deficiencies have jeopardized the integrity of the overall system by negating key controls resulting in overspending their appropriation, omissions and errors in financial reports, failure to comply with state requirements for contracting and purchasing, and other key fiscal areas.



In our opinion, because of the matters discussed in the preceding paragraph, the system of internal accounting control and fiscal procedures at CHRB in effect as of May 10, 1982, taken as a whole, was not sufficient to meet the broad objectives stated above.

Our report presents findings and recommendations to improve CHRB's system of internal control and fiscal procedures. Because of the weaknesses found in purchasing procedures, we will advise the Department of General Services to withdraw the Board's purchase delegation.

  
Richard L. Cutting, Chief  
Financial and Performance Accountability  
(916) 322-2985

Attachment



**CALIFORNIA HORSE RACING BOARD**

1010 Hurley Way, #101  
Sacramento, Ca. 95825  
(916) 920-7178



June 14, 1982

Richard L. Cutting, Chief  
Financial and Performance Accountability  
Department of Finance  
1025 P. Street, Room 283  
Sacramento, CA 95814

Upon the review and consideration of the findings and recommendations contained in the Financial and Performance Accountability Report entitled, "California Horse Racing Board Review of the System of Internal Accounting Control and Fiscal Procedures" of May, 1982, number 855-001, the following response is presented:

**CHRB Internal Accounting Control and Fiscal Procedures Are Adequate.**

- . Assets are safeguarded from unauthorized use or disposition.
- . Financial records are reliable to permit the preparation of financial statements.
- . Other fiscal procedures ensure the reliability and integrity of information.
- . Control systems enable compliance with policies, plans, procedures, laws and regulations, including the State Administrative Manual, and where deficient are corrected.

The CHRB procedures are not without fault and where deficient have been corrected as indicated in our response to the individual recommendations made in the report. An omission and error made in a prior fiscal year, without intention or design, should be reconciled against the situation by which it occurred.

Withdrawal of the rarely used purchase delegation will have no meaningful impact on the Board's regular purchase procedures and no objection to such withdrawal is made by the Board.

Referring to the individual recommendations by number .....

1. The Board is pursuing legislation for a deficiency bill to cover the unpaid 1980/81 liabilities as recommended.

2. & 3. With the exception of the isolated incident regarding the unreported liabilities for the 1980/81 F.Y., the Board has always reflected its total valid liabilities at year end when preparing and submitting financial statements. It is a matter of historical record as reflected by past audits of the Board's financial reports that the 1980/81 F.Y. report was an isolated and unfortunate incident. Action has been taken to insure this single instance will not be repeated.

We note that Section 7976 of the S.A.M. states, "If an agency determines that there are material differences between amounts it occurred as of June 30 and subsequent events (receipts and expenditures) relating to prior year's funds, it will report to the Financial Analysis and Reports Section of the Accounting Division, State Controller's Office at once for instructions. "Material" is defined for this purpose as a net change in the total accrued expenditures of \$100,000. or more."

4. With the exception of the 1980/81 F.Y. report, it is a matter of record that the Board's expenditures have never exceeded its appropriations.

However, in order to further improve on our fiscal procedures, the Board will expand its allotment ledger cards. As an example, the General Expense Category in the printed budget contains printing, postage, communications, and Interstate information services. We are establishing an allotment ledger card for each expenditure within the General Expenses category. The allotments will be established based upon our previous year's experience and the best estimates available. This should eliminate the transferring of allotment amounts during the fiscal year and possibly eliminate totally any transfers of allotment. It is our plan to work totally within each specific allotment for the 1982/83 Fiscal Year, and workloads will be adjusted to match available appropriated resources.

5. This agency has always reimbursed employees on official travel in accordance with the Board of Control rules. Audit findings did not reflect anything to the contrary. However, due to the Governor's Executive Order #97-82, the Board was required to reduce the entire budget year travel allotment by 10% or \$9,750. At the time of receiving the Executive Order, the Board had already expended close to 9 months of its travel allotment and had committed itself to the supervision of additional race meetings. Therefore, it became a matter of priorities where to cut in order to meet the mandated order within the remaining 3 month period for 1981/82 F.Y.

After analyzing our situation, we estimated we could meet the required reduction by reducing the commuting assignments of employees. This appeared to be sound business practice without

material jeopardy to the Board's essential travel operations, and appears within the policy discretion of the agency.

6. thru 12. Procedures for leasing and use of Standard Agreement Form #2 will be prepared where required and we will obtain competitive bids where required.

With respect to the Portable Computer Terminals, a State Standard Agreement form was prepared for the 1981/82 F.Y., and we stated that such rental was exempt from the Department of General Services approval pursuant to Section 1206 S.A.M. (Repetitive nature of the contract). Our interpretation of the State Administrative Manual apparently differs from the Auditors, but we will defer to the recommendation.

Micro-Disc Processor: With respect to this item we called the Office of Procurement prior to preparing the sub-purchase order and were advised that such form was sufficient for such monthly lease because it did not exceed \$500. Again we relied on Section 1206 S.A.M. in that this is a repetitive type monthly rental which amounted to \$169. per month. The notation of this transaction is a matter of record on Sub-purchase Order #35 dated 8/26/80.

13., 14, & 15. Obtaining authorization from the Office of Procurement for all purchases which exceed the delegation limit has always been the practice of this agency. It has not been the practice of this agency to split orders to circumvent the expenditures limitations. The one isolated case reported by the auditors in December, 1981, occurred because an emergency supply deficiency existed affecting Board's licensing function. However, such approval was subsequently acquired. The audit findings only reflected an isolated case and not a practice of the Board. Inventory control has been improved to prevent recurrence. Apparently there is a belief that State Agencies are being hampered in their ability to purchase. The State Assembly has recently passed a bill to give State Agencies greater flexibility in administering their own purchasing programs.

16. Whenever we do have a delegated purchase order, which is rare, we will submit such order on a weekly basis as recommended.

17. With respect to the Small Business Monitoring Report, we can only think of two transcribing reporting companies that might fall within such category. We will review the procedures and comply with the recommendation.

18. This recommendation appears to duplicate the reporting requirement of Recommendation #16.

19. The Board's Accounting staff consists of 3 persons: the Accounting Officer, Accountant I and an Accounting Technician. For each accounting employee not to perform more than one of the seven types of duties stated in your recommendation is impossible with the present staffing.

We separate duties amongst the three positions in accordance with sound internal control procedures. In order to separate the seven duties the Board must be given additional accounting personnel. Furthermore, to have personnel other than qualified accounting personnel prepare and process accounting documents would be contrary to State law governing work classifications.

Audit findings did not disclose any material defects in the accounting procedures and records attributable to lack of separation of duties.

We will submit our internal control plan to the Fiscal Systems and Consulting Unit for review and comment.

20. Prior to May, 1982, we never had a check amounting to over \$15,000., not payable to State Agencies. Both the Manager and the Executive Secretary will sign such checks in the future.

21. We do maintain a log of all checks written. Our disbursement register reflects every check recorded in numerical order.

22. We do maintain a strict control over blank checks. The stock is kept in a locked metal cabinet file next to the Accounting Officer's desk. There is absolutely no need to use transfer receipts to document any transfer of check stock as such inventory never leaves the confines of the one location adjacent to the Accounting Officer's desk.

23. Dishonored check revenue is being recorded in the revenue register rather than the general journal. Previously we were recording such revenues in the general journal because of the small volume and in order to isolate such names of persons who owed monies on such dishonored checks.

24. Standard Receipt Stock will be used whenever it may be required.

25. To use transfer receipts to localize accountability whenever cash or negotiable instruments are transferred between employees does not appear to be a practical recommendation for the three member accounting staff working in the same office. Such transfers are seldom made in any event.

26. The only CHRB valuables that we can think of is the stock of blank checks and unused airline tickets which are adequately controlled. Audit findings did not reflect any missing items.

27. The law requires the Board to collect revenues on a weekly basis. The statute was enacted by the legislature who represent the people of the State of California and the Board should not be directed to pursue a change which is in the province of the Legislative branch.

28. The Revolving Cash book is being maintained as prescribed by Section 8191 S.A.M.

29. We have an established control over checks written. We have an established sequence of checks issued and recorded in the Cash Disbursement Register and we maintain a separate control ledger for each revolving fund.

Fair and Exposition Fund - Support Budget  
Special Trust - Stewards' Compensation Fund

Special Trust - Standardbred Sires Stakes Program

The recommendation to establish a block sequence of checks such as 0-100, 101-200, for each Revolving Fund program is not as efficient or as strict a control as currently maintained. At any given period we can review our disbursement register as to checks issued and verify to the unused check inventory. Under the block concept one would always have to be verifying all the missing gaps within the blocks. As an example, we issue only about two checks per month for the Sires Stakes program and about 28 checks per month for the Stewards Compensation Program. Our current procedure is efficient with every check accounted for in numerical order and it appears to be in accord with a fundamental concept of good accounting principles.

Audit findings did not reflect any of the Revolving Fund balances as being inaccurate.

30. Postage stamps are only used for official correspondence. We do not maintain a cash purchase fund, nor believe it to be necessary.

Audit findings did not reflect that the postage was being used for other than official business.

31. The Board was advised that it should assess for its administrative costs for the Stewards Compensation Program, and will pursue amendment to Section 19442.

32. It is not the Board's practice to issue checks less than \$1.00.

There was a one-time isolated incident where a check was issued for under \$1.00, under unusual circumstances, and this does not represent a usual procedure.

33. Our travel policies do conform to Section 0700 S.A.M.

34. The Stewards' minutes are prepared on a daily basis and submitted weekly to the Board. The minutes of the Stewards reflect their daily duties and their presence on duty each day. Each Steward signs the weekly report. The minutes verify the positive attendance pursuant to the contract terms.

35. We do prepare a report indicating the evidence of receipt of goods. The form is maintained to indicate the date ordered, item ordered, delivery date expected and date received in our purchase estimate file. In addition, the packing slip is maintained and verified to the actual invoice before processing the payment.

36. We have always exercised great care in the preparation of our year-end statements. The isolated instance referred to in Recommendation 1 is the sole evidence of an incorrect year-end statement.

37. The certification of fixed assets form for the year ended June 30, 1981, was completed and signed by the Executive Secretary. In the future we will specifically type in the appropriate wording to certify such report.

38. The Administrator or Manager will certify all year-end reports.

39. Dishonored checks will be subject to an adjusting entry to reflect proper revenues at the year-end.

40. We have applied for discharge of Accountability to the State Board of Control for those dishonored checks determined to be uncollectible.

First Transmittal - November 1981 - \$622.50  
Second Transmittal - April 1982 - \$461.00

41. & 42. An invoice register will be maintained per S.A.M. 10507 for the few items sent out subject to reimbursement.

43. & 44. The invoice register is sufficient control. As a practical matter it is unreasonable to prepare a shipping order for each publication sent out to subscribers. The employee preparing such orders for mailing does not handle billing invoices or payment receipts.

45. & 46. This recommendation is being complied with. Audit findings did not reflect that the Bank Reconciliations were not properly reconciled.

47. To date all unpaid obligations have been encumbered in the Allotment Expenditure Ledger.

48. All control books have always been recorded in ink. We will record in ink the one register that was not. It is to be noted that source documents are a matter of record behind each recorded entry.

49. New control ledger cards were prepared for this current fiscal year. We might add for information purposes, the prior year ledger cards should be handy to review similar prior year expenditures. However, we will prepare a new prior year ledger card each year to

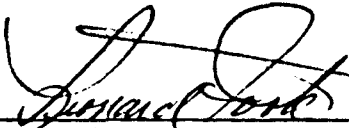


satisfy the recommendation.

50. We do have a person designated for property and equipment control. The designation was prepared three years ago and a physical inventory was taken three years ago and signed by the person in control of such property and equipment. The inventory report is a matter of record in the Board's office.

\* \* \* \* \*

The State Administrative Manual is an instrument for conveying a uniform approach to agency management throughout the State. The very technical recommendations covering the Board's operations in the 1981/1982 fiscal year were not indicative of errors of material nature which would affect the total operations of the Board's program; merely isolated errors, inadvertance on a one-time basis and not a pattern of mispractice. Professional independent audit standards require material deficiencies or a pattern of mispractice to constitute a finding of "major deficiencies in the CHRB's system of internal control and fiscal procedures." It is our conclusion that no such finding of major deficiencies is justified. The findings did not disclose any evidence that the CHRB failed to collect all State revenues from horse racing operations, nor was there any evidence that the Board's payments were inaccurate or not valid or misspent except for the isolated instance in 1980/1981 when the Board exceeded its appropriation for reasons known to the Department of Finance. We have no doubt, and our belief is shared by the Chief of the Audits Division and the Auditors preparing the report, that the majority of recommendations in the instant report are applicable to nearly every other State agency. Our concern is not with the adoption of the recommendations made in the audit report, most of which have already been implemented or initiated, but with the impression left by the report that the total number of technical recommendations implies an unreliable internal control over the Board's operations. Such an implication is not justified unless there is a finding of material discrepancies in the Board's accounts which are not evident.

  
\_\_\_\_\_  
Leonard Foote  
Secretary

LF:gw



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(VICE CHAIRMAN)  
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SALLY TANNER  
CHESTER WRAY

# California Legislature

## Assembly Committee

on

## Governmental Organization

FRANK VICENCIA, 54TH A.D.  
CHAIRMAN

APPENDIX F  
STAFF  
PARKE D. TERRY  
PRINCIPAL CONSULTANT  
JOSEPH LANG  
CONSULTANT  
ELSIE A. GEE (LEE)  
COMMITTEE SECRETARY  
ROOM 4112, STATE CAPITOL  
SACRAMENTO, CA 95814  
(916) 445-3451

July 22, 1982

Mr. Nathan Shapell  
Chairman  
Commission on California State Government  
on Organization and Economy  
11th & L Building #550  
Sacramento, CA 95814

Dear Nathan:

I have carefully reviewed the commission's draft report on California horse racing and am compelled to take strong exception to the findings and recommendations made relative to Assembly Bill 3383. I do this because the report contains a number of factual errors, fails to consider important mitigating factors in the revenue decline attributed to AB 3383, and reaches conclusions that cannot be supported by a full and fair analysis of the economic considerations that contributed to the passage of the bill.

While it is true that state horseracing revenues declined by \$14 million between 1980 and 1981, the report ignores the fact that about \$9 million of this loss can be attributed to a provision of the bill that reduced the take-out on conventional (win, place, show) wagers from 15.75 percent to 15.00 percent. In effect, this provision resulted in the state foregoing revenue in order to increase the amounts returned to holders of winning tickets. In theory, these additional winnings should be re-bet and thereby increase the total wagering at each track. While it is still too early to assess the success of this experiment, the comparatively large increases in handle and attendance experienced in 1981 are clearly consistent with the argument that a lower take-out from the racing fan will ultimately stimulate wagering and increase state revenues beyond levels that could have been achieved without the cut in take-out.

The report asserts that any increase in wagering activity from 1980 to 1981 is "accounted for as a continuation of historic growth in wagering and the innovation of Pick-Six wagering." I do not see any support in the data for this conclusion. Growth in handle and attendance during 1981 clearly exceeded the 10-year historic growth rates. Moreover, the innovation of the Pick-Six wagering occurred in April of 1980, nearly nine months prior to the effective date of AB 3383. Consequently, any growth attributable to the Pick-Six had already occurred and could not have been sustained in 1981 without further growth incentives. In my judgment it is more reasonable to conclude that AB 3383 was largely responsible for the extraordinary growth in handle during 1981. This was achieved by the increase in racing weeks, the stimulative effect of the take-out reduction, and better races made possible by larger purses.

Finally, I would like to comment on the report's contention that AB 3383 constituted an unjustified "giveaway" of state revenues to the racing industry.

In fact, the Temple, Barker, and Sloane study provided ample justification for a downward adjustment in state license fees and additional revenues for horsemen and tracks. Contrary to the statement in the commission's report, the consulting firm was not retained by the racing associations but by the California Horse Racing Board. Although the tracks paid for the study, neither they nor the horsemen had any say in the selection of the firm or the findings or recommendations that were reported.

With respect to horsemen, the TBS report clearly showed that the vast majority are losing money. The costs of buying, training, and maintaining a horse at the track are not being offset by a purse structure that adequately compensates the owners, let alone provides them with a profit. Granted there are some very successful stables and there are some wealthy horsemen who participate as a hobby or tax shelter. But for most, racing is a full-time business, and an unprofitable one at that. Unless the state is willing to make it financially attractive for a majority of horsemen to race, there will simply be no racing and no state racing revenues to distribute.

The case for racing associations is more difficult to evaluate since the state does not control non-parimutuel revenues (admissions, parking, concessions, programs, etc.) and has no say over operating expenses. Nevertheless, racetracks must make a profit in order to stay in business and must see a return that justifies investment of their capital assets in racing. If any of California's five major privately held racetracks were to shift their assets elsewhere, the state's racing industry would be jeopardized and very large state revenue losses would result.

July 22, 1982

I must add that my independent review of financial ratios published in Standard and Poor's Industry Surveys and in Moody's Investors Fact Sheets does not support the commission's assertions that racing association profits are out of line with other comparable industries. For example, Hollywood Park's 17.84 percent return on equity in 1980 was exceeded by four gaming companies, including Caesars New Jersey (20.26%), Showboat, Inc. (20.05%), Resorts International (19.83%), and Caesars World (19.10%). Two other gaming companies, MGM Grand Hotels and Bally Manufacturing, were only fractionally lower, at 17.39% and 17.13%, respectively. Hollywood Park's 1980 return on equity was also exceeded by a number of well-known entertainment companies, including Columbia Pictures (21.7%), Warner Communications (19.9%), Eastman Kodak (20.2%), and Technicolor (29.9%). In short, while racing association return on equity is above average for American business, it does not appear to be unreasonably high given the unique character of racing and the capital intensive structure of the industry.

It should be well understood that AB 3383 anticipated a short-term revenue loss to the state as a condition of placing horsemen and racing associations on a firm financial footing for the future. The \$14 million decline in revenues was expected and actually was somewhat less than the \$18 million decline projected by the Department of Finance for fiscal 1981-82.

I firmly believe that AB 3383 has achieved its objectives at a very reasonable cost to the state treasury. I am confident that with this legislation we will be able to sustain a high level of growth and ultimately see greater state revenues that would have been achieved under the prior law.

Sincerely,



FRANK VICENCIA

FV:eag

